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## *Records*

## *Record of Policy Actions of the Board of Governors*

### **Regulation D**

#### **Reserve Requirements of Depository Institutions**

##### **November 16, 2000—Amendments**

The Board amended Regulation D to decrease the amount of net transaction accounts at depository institutions to which a lower reserve requirement applies (low reserve tranche), and to increase the amount of reservable liabilities that is exempt from reserve requirements (reserve exemption level) for 2001, effective for the reserve computation period beginning November 28, 2000, for institutions reporting weekly.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

Under the Monetary Control Act of 1980, depository institutions, Edge Act corporations, agreement corporations, and U.S. agencies and branches of foreign banks are subject to reserve requirements set by the Board. The act directs the Board to adjust annually the amount of the low reserve tranche to reflect changes in net transaction accounts at depository institutions. Recent declines in net transaction accounts warranted a decrease in the low reserve tranche to \$42.8 million, and the Board amended Regulation D accordingly.

The Garn–St Germain Depository Institutions Act of 1982 establishes a

zero percent reserve requirement on the first \$2 million of an institution's reservable liabilities. The act also provides for annual adjustments to that exemption amount based on increases in reservable liabilities at depository institutions. Recent growth in reservable liabilities warranted an increase in the amount exempted from reserve requirements to \$5.5 million, and the Board amended Regulation D accordingly.

For institutions reporting weekly, the amendments are effective with the reserve computation period beginning November 28, 2000, and the corresponding reserve maintenance period beginning December 28, 2000. For institutions reporting quarterly, the amendments are effective with the reserve computation period beginning December 19, 2000, and the corresponding reserve maintenance period beginning January 18, 2001.

To reduce the reporting burden on small institutions, depository institutions having total deposits below specified levels are required to report their deposits and reservable liabilities quarterly or less frequently, while larger institutions must report weekly. To reflect increases in the growth rate of total deposits at all depository institutions, the Board increased the deposit cutoff levels used in determining the frequency and detail of depository reporting to \$101 million for nonexempt depository institutions, beginning in September 2001.

In July 2000 the Board eliminated the exempt deposit cutoff and discontinued the quarterly report associated with that cutoff. Exempt institutions (those with

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NOTE. In voting records throughout this chapter, Board members, except the Chairman and Vice Chairman, are listed in order of seniority.

total reservable liabilities equal to or less than the exemption level of \$5.5 million) with at least \$5.5 million in total deposits may report annually, and exempt institutions with less than \$5.5 million in total deposits are not required to file deposit reports.

## **Regulation G**

### **Disclosure and Reporting of CRA-Related Agreements**

#### **December 21, 2000—Adoption of New Regulation**

The Board adopted a new Regulation G to implement the CRA sunshine provisions of the Gramm–Leach–Bliley Act. Those provisions establish annual reporting and public disclosure requirements for certain written agreements that relate to the Community Reinvestment Act of 1977 (CRA) and are entered into between insured depository institutions or their affiliates and non-governmental entities or persons. The new Regulation G is effective April 1, 2001.

Votes for this action: Messrs. Greenspan, Ferguson, Meyer, and Gramlich. Absent and not voting: Mr. Kelley.

The Board, jointly with the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, approved new rules to implement the CRA sunshine provisions of the Gramm–Leach–Bliley Act. The rules require that insured depository institutions, their affiliates, and other entities and persons that are parties to certain written agreements that are in fulfillment of the CRA make the agreements available to the public and the appropri-

ate federal financial supervisory agency and file annual reports concerning the agreements with the appropriate supervisory agency. The rules also identify the types of agreements covered, describe how parties to covered agreements must make the agreements available to the public and the appropriate supervisory agency, explain the type of information required to be included in the annual report to the appropriate supervisory agency, and define terms used in the act.

## **Regulation H**

### **Membership of State Banking Institutions in the Federal Reserve System**

#### **March 10, 2000—Interim Amendment**

The Board approved an interim amendment to Regulation H to permit qualifying state member banks to establish financial subsidiaries that engage in activities that are financial in nature or incidental to financial activities, effective March 11, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Gramm–Leach–Bliley Act authorizes qualifying banks to control or hold an interest in a financial subsidiary. A financial subsidiary may engage in activities that have been determined under the act to be financial in nature or incidental to financial activities and in activities that the parent bank is permitted to conduct directly. The interim amendment to Regulation H is substantially similar to the interim rule adopted for financial subsidiaries of national banks and provides a streamlined notice

procedure for state member banks with guidance on the qualifying criteria. State member banks may continue to retain and establish operations subsidiaries that engage only in activities that the parent bank may conduct directly and that are conducted on the same terms and conditions applicable to the bank. The Board also published the interim amendment for comment.

### March 13, 2000—Interim Amendment

The Board approved an interim amendment to Regulation H to provide an alternative standard for debt ratings that certain large state member banks may satisfy to establish a financial subsidiary, effective March 14, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Board and the Department of the Treasury jointly approved an interim rule under the Gramm–Leach–Bliley Act to permit certain large state member and national banks to establish a financial subsidiary by qualifying under an alternative requirement for rated debt. The act provides that a state member or national bank that is ranked among the largest fifty insured banks may control a financial subsidiary only if the bank meets certain criteria, which include having an issue of highly rated debt outstanding. State member or national banks that are among the second fifty largest insured banks may control a financial subsidiary if they meet this debt rating criterion or an alternative criterion established by the Board and the Department of the Treasury. The interim rule, which is incorporated in Regulation H for state member banks,

provides that a bank in the second fifty largest grouping meets this alternative requirement if it has a current long-term issuer credit rating from a nationally recognized statistical rating organization that is in the three highest investment-grade rating categories used by the rating organization. The Board and the Department of the Treasury also published the interim rule for comment.

### November 14, 2000—Amendments

The Board amended Regulation H to provide consumer protection rules for the sale of insurance products by depository institutions, effective October 1, 2001.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Board, jointly with the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, approved new rules to implement provisions of the Gramm–Leach–Bliley Act that provide consumer protections applicable to retail sales, solicitations, advertising, or offers of insurance by a depository institution or by any person who is engaged in such activities at an office of the institution or on behalf of the institution.<sup>1</sup> The rules prohibit certain practices, require certain disclosures to prospective buyers and qualifications for persons selling insurance, prescribe areas in the depository institution for insurance sales activities, and limit referral fees for bank employees.

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1. The agencies extended the original April 1 effective date on March 14, 2001.

## **Regulation H**

### **Membership of State Banking Institutions in the Federal Reserve System**

## **Regulation Y**

### **Bank Holding Companies and Change in Bank Control**

#### **November 8, 2000—Interim Amendments**

The Board approved interim amendments to Regulations H and Y to revise the capital treatment under its market risk rules for cash collateral that is posted in connection with certain securities borrowing transactions, effective January 4, 2001, and available to U.S. banking organizations beginning December 5, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Board, jointly with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, approved an interim rule that effectively lowers the capital requirement when cash collateral is posted for certain securities borrowing transactions. The interim rule applies only to banking organizations with significant trading activities that are subject to capital treatment under the agencies' market risk rules. It is intended to align the capital requirements for these transactions more appropriately with the risk involved and to align the capital treatment for U.S. banking organizations with the capital treatment applied to their domestic and foreign competitors. The Board also published the interim rule for comment and sought comment

on the capital treatment of securities borrowing transactions when securities are posted as collateral.

## **Regulation P**

### **Privacy of Consumer Financial Information**

#### **May 10, 2000—Adoption of New Regulation**

The Board adopted a new Regulation P to provide notice requirements and restrictions on a financial institution's ability to disclose nonpublic personal information about consumers to unaffiliated third parties. The new Regulation P is effective November 13, 2000, and compliance is optional until July 1, 2001, to allow sufficient time for financial institutions to develop policies, procedures, and systems to implement the rule.

Votes for this action: Messrs. Greenspan, Ferguson, Meyer, and Gramlich. Absent and not voting: Mr. Kelley.

The Board, jointly with the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, approved new rules to implement the consumer privacy provisions of the Gramm–Leach–Bliley Act. Under the rules, a financial institution is required to provide customers with a notice of its privacy policies and practices. The rules also prohibit a financial institution from disclosing nonpublic personal information about a customer to unaffiliated third parties unless the institution satisfies certain notice and opt-out requirements and the customer has not elected to opt out of the disclosure.

## **Regulation Y** **Bank Holding Companies and** **Change in Bank Control**

### **January 18, 2000—Interim Amendment**

The Board approved an interim amendment to Regulation Y to provide procedures for bank holding companies and foreign banks with U.S. offices that meet certain criteria to elect to be treated as financial holding companies, effective March 11, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The interim amendment, which implements the financial holding company provisions of the Gramm–Leach–Bliley Act, enables qualified organizations to engage in a broad range of securities, insurance, and other financial activities. The Board adopted an interim amendment with an effective date that coincided with the effective date of the act to allow organizations to qualify as financial holding companies as soon as authorized by law. The Board also published the interim amendment for comment.

### **March 10, 2000—Interim Amendment**

The Board approved an interim amendment to Regulation Y to apply two of the eight operating standards currently applicable to so-called section 20 affiliates of bank holding companies to financial holding companies engaged in certain securities activities, effective March 11, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

Bank holding companies may underwrite, deal in, and make a market in securities to a limited extent through section 20 subsidiaries. These subsidiaries are subject to eight operating standards that address potential risks and conflicts associated with the affiliation of a bank and a securities firm. The Gramm–Leach–Bliley Act authorizes financial holding companies to engage in these securities activities. The act also authorizes the Board to impose prudential limitations on relationships or transactions between a depository institution and any affiliate, including a securities affiliate.

After considering the overall regulatory approach reflected in the Gramm–Leach–Bliley Act, the Board applied two of the eight operating standards as prudential limitations on transactions involving securities affiliates of financial holding companies. These limitations require that when a domestic bank or thrift institution, or a U.S. branch or agency of a foreign bank, makes intraday extensions of credit to an affiliated securities firm, it does so on market terms consistent with section 23B of the Federal Reserve Act. The limitations also apply sections 23A and 23B of the Federal Reserve Act to certain covered transactions between a U.S. branch or agency of a foreign bank and its U.S. securities affiliate. The limitations on bank holding companies that conduct securities activities through section 20 subsidiaries are not affected by the interim rule. The Board also published the interim amendment for comment.

### March 10, 2000—Interim Amendments

The Board approved interim amendments to Regulation Y to provide a list of financial activities that are permissible for financial holding companies and to implement certain procedures for conducting financial activities, effective March 11, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Gramm–Leach–Bliley Act authorizes a bank holding company or foreign bank with U.S. offices that qualifies as a financial holding company to engage in a broad range of activities that the statute defines as being financial in nature. The act also authorizes the Board, in consultation with the Secretary of the Treasury, to determine that additional activities are financial in nature or incidental to a financial activity. In addition, the act authorizes the Board to allow a financial holding company to engage in activities that are complementary to a financial activity.

The interim rule provides a consolidated list of all activities that the act defines as financial in nature and establishes procedures that are required for a financial holding company to engage in those activities. In most cases, a financial holding company is only required to notify the Board in writing within 30 days of commencing, or acquiring a company that is engaged in, a financial activity. The interim rule also establishes a procedure for requesting that the Board, in consultation with the Secretary of the Treasury, determine that an activity is financial in nature or incidental to a financial activity. In addition, the interim rule provides a procedure for a financial holding company to request the Board's prior approval to engage in an

activity that is complementary to a financial activity engaged in by the company. The Board also published the interim rule for comment.

### March 10, 2000—Interim Amendments

The Board approved amendments to its interim rule on procedures for bank holding companies and foreign banks with U.S. offices that meet certain criteria to elect to become or be treated as financial holding companies, effective March 15, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

In light of its experience in processing financial holding company elections under an interim rule issued in January 2000, the Board approved changes in the interim rule's procedures for foreign banks. These amendments provide that an election by a foreign bank that meets the well-managed and well-capitalized standards will become effective on the thirty-first day after the election is filed unless the election is determined to be ineffective or the review period is extended by agreement with the bank. All U.S. depository institution subsidiaries of electing foreign banks, including savings associations and nonbank trust companies, must meet the same requirements as depository institution subsidiaries of bank holding companies. Foreign banks in countries that have not been reviewed by the Board for comprehensive consolidated supervision were encouraged to use the pre-clearance process, which allows a foreign bank to request a determination of its qualifications before it files an election to be treated as a financial holding company. In addition, the interim amendments remove the compliance rating compo-

nent from the definition of well managed when applying this standard to depository institution subsidiaries of a bank holding company that is electing to become a financial holding company. The Board also published the amendments to the interim rule for comment.

### March 16, 2000—Interim Amendments

The Board approved interim amendments to Regulation Y governing the merchant banking activities of financial holding companies, effective March 17, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Board and the Department of the Treasury jointly approved an interim rule incorporated in Regulation Y to implement the merchant banking provisions of the Gramm–Leach–Bliley Act. The provisions authorize financial holding companies to make investments as part of a bona fide securities underwriting, merchant banking, or investment banking activity. The interim rule permits a financial holding company to make investments in any amount of shares, assets, or ownership interests of any type of nonfinancial company. Merchant banking investments may not be made by or on behalf of depository institutions or any subsidiary of a depository institution. In addition, the rule includes provisions on record keeping and reporting, risk management practices, holding periods for merchant banking investments, limits on involvement in the management or operation of portfolio companies, and cross-marketing and lending restrictions on activities between depository institution subsidiaries and portfolio companies. The rule also requires Board review of the risk

management policies of financial holding companies that have significant exposure to merchant banking investments. The Board and the Department of the Treasury also published the interim rule for comment.

At the same time, the Board published for comment a proposed rule governing the regulatory capital treatment of nonfinancial equity investments held directly or indirectly by bank holding companies. The proposed rule, developed in consultation with the Department of the Treasury, would generally impose a 50 percent capital charge on nonfinancial investments made under the merchant banking authority of the Gramm–Leach–Bliley Act and certain other legal authorities.

### December 13, 2000—Amendments

The Board amended Regulation Y to provide that acting as a “finder” in transactions is incidental to a financial activity and, therefore, permissible for financial holding companies, effective January 22, 2001.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Board, in consultation with the Secretary of the Treasury, authorized financial holding companies to act as a finder by bringing together buyers and sellers of products and services for transactions that the buyers and sellers themselves negotiate and consummate. The amendment adds acting as a finder to the list of activities in Regulation Y that are permissible for financial holding companies, provides specific examples of permissible and impermissible services, and requires financial holding companies to provide appropriate disclosures to distinguish the products and services that are offered or sold by the



company from those offered by a third party through the company's finder services.

#### December 21, 2000—Amendments

The Board made final an interim rule amending Regulation Y to provide procedures for bank holding companies and foreign banks with U.S. offices that meet certain criteria to qualify as financial holding companies, effective February 2, 2001.

Votes for this action: Messrs. Greenspan, Ferguson, Meyer, and Gramlich. Absent and not voting: Mr. Kelley.

The Board made final an interim rule issued in January 2000 that implements the financial holding company provisions of the Gramm–Leach–Bliley Act. The final rule sets forth the capital, management, and Community Reinvestment Act requirements that bank holding companies and foreign banking organizations must meet to qualify as financial holding companies and contains provisions that apply when a financial holding company ceases to meet the prescribed requirements. In addition to listing activities that are financial in nature, and thus permissible for financial holding companies, the final rule provides a procedure for requesting that the Board, in consultation with the Secretary of the Treasury, determine that additional activities are financial in nature or incidental to a financial activity; the rule also provides a procedure for requesting that the Board determine that an activity is complementary to a financial activity and thus permissible.

In the final rule, the Board made several changes to provisions regarding foreign bank financial holding companies that had been included in the interim rule. Among other changes, the leverage

ratio was removed from the screening test in the definition of well capitalized for foreign banks, but it was added to the list of factors that the Board can consider for purposes of the comparability review of foreign bank capital required by the final rule. In addition, the Board revised the definition of well managed applicable to foreign bank financial holding companies to require that a foreign bank's U.S. branches, agencies, and commercial lending companies have a satisfactory composite rating, rather than satisfactory individual ratings as required by the interim rule.

#### December 21, 2000—Interim Amendment

The Board approved an interim amendment to Regulation Y that defines three categories of activities as being financial in nature or incidental to a financial activity and, therefore, permissible for financial holding companies, effective January 2, 2001.

Votes for this action: Messrs. Greenspan, Ferguson, Meyer, and Gramlich. Absent and not voting: Mr. Kelley.

The Board, jointly with the Secretary of the Treasury, issued interim rules to implement provisions of the Gramm–Leach–Bliley Act that identify the following categories of activities as being financial in nature or incidental to a financial activity and, therefore, permissible for financial holding companies and financial subsidiaries of national banks: (1) lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities, (2) providing any device or other instrumentality for transferring money or other financial assets, and (3) arranging, effecting, or facilitating transactions for the account of third

parties. The interim rules provide procedures for financial holding companies, financial subsidiaries of national banks, or others to request that the Board or the Secretary of the Treasury, as appropriate, designate particular activities as included in one of the three categories. The Board and the Secretary also published the interim rules for comment.

## **Regulation Z**

### **Truth in Lending**

#### **September 19, 2000—Amendments**

The Board amended Regulation Z and its commentary to revise the disclosure requirements for credit and charge card applications and solicitations, effective September 27, 2000, with mandatory compliance as of October 1, 2001.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Truth in Lending Act, as implemented by Regulation Z, promotes the informed use of consumer credit by requiring disclosures about its terms and costs. The annual percentage rate (APR) and other cost information generally must be disclosed in tabular form in credit and charge card solicitations and applications. The amendments require that disclosures be readily noticeable to consumers as well as in a reasonably understandable form, and that the APR for purchase transactions be in 18-point type. APRs for cash advances and balance transfers must be included in the table, and balance transfer fees also must be disclosed. Regarding cost information, the amendments provide additional guidance on the level of detail required or permitted to be in the table and on the requirement that the table be prominently located.

## **Rules of Practice for Hearings**

#### **October 2, 2000—Amendment**

The Board amended its rules of practice for hearings to increase the maximum amounts of its civil money penalties to account for inflation, effective October 12, 2000.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Federal Civil Penalties Inflation Adjustment Act of 1990, as amended, requires federal agencies to adjust their civil money penalties under a prescribed cost-of-living adjustment at least once every four years. The amendment implements the mandatory numerical adjustments required by the act and covers violations occurring after October 12, 2000.

## **Policy Statements and Other Actions**

#### **April 27, 2000—Policy Statement on Payments System Risk**

The Board approved modifications to its daylight overdraft posting rules to reflect the enhanced capabilities of the new Treasury Investment Program (TIP), effective July 10, 2000, but subsequently postponed the modifications in its July 6 policy action, discussed below.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

The Federal Reserve System implemented TIP to replace the Treasury tax and loan system (TT&L), and the Board changed its posting rules to account for TIP transactions. The posting rules pro-

vide a schedule for posting debits and credits to institutions' Federal Reserve accounts so that the intraday account balances can be measured for compliance with the Federal Reserve's Policy Statement on Payments System Risk. Before TIP's implementation, most TT&L debit transactions were posted to institutions' Federal Reserve accounts after the close of Fedwire. TIP transactions, however, are processed and posted on a flow basis throughout the day. The Board provided a transition period during which most TIP transactions that resulted in debits to depository institutions' accounts were posted after the close of Fedwire.

#### **July 6, 2000—Policy Statement on Payments System Risk**

The Board approved minor corrections to its daylight overdraft posting rules, which had been modified in light of the new Treasury Investment Program (TIP) by the Board's policy action on April 27, discussed above. The Board also postponed the original July 10, 2000, effective date for the modified rules because of the delay in implementing TIP.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

Minor corrections were made to the posting times for transactions involving same-day Treasury withdrawals, main account administrative withdrawals, and special direct-investment withdrawals. TIP implementation and the modified rules subsequently took effect on October 23, 2000.

#### **October 30, 2000—Federal Reserve ACH Deposit Deadlines and Pricing Practices for Transactions Involving Private-Sector ACH Operators**

The Board approved a new approach to pricing automated clearinghouse (ACH) transactions by Federal Reserve Banks to enhance competition for services to depository institutions, effective in 2001.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.

Federal Reserve Banks and private-sector ACH operators (PSOs) rely on each other to process some transactions in which the originating depository institution or receiving depository institution is not a customer of theirs (interoperator transactions). The new pricing procedures permit Reserve Banks and PSOs to negotiate deposit deadlines and fees for their interoperator transactions. Only PSOs qualifying as operators under the rules of the National Automated Clearing House Association are eligible for the new procedures. New interoperator deadlines will be implemented not later than June 2001, and new fees will be established not later than September 2001.

#### **Discount Rates in 2000**

During 2000, the Board of Governors approved three increases, totaling one percentage point, in the basic discount rate charged by the Federal Reserve Banks. These actions, taken in February, March, and May, raised the basic rate from 5 percent to 6 percent. The rates

for seasonal and extended credit, which are set on the basis of market-related formulas, were changed more frequently, and they exceeded the basic rate by varying amounts during the year. Rates charged under the temporary Century Date Change Special Liquidity Facility (SLF), which was available through April 7, continued to be set at 150 basis points above the intended federal funds rate established by the Federal Open Market Committee (FOMC).

### Basic Discount Rate

The Board's decisions on the basic discount rate were made against the background of the policy actions of the FOMC and related economic and financial developments. These developments are reviewed more fully in other parts of this Report, including the minutes of the FOMC meetings in 2000.

#### *January through Mid-May: Three Increases in the Basic Rate*

During the closing weeks of 1999 and the early weeks of 2000, monetary policy was directed toward promoting stable conditions in financial markets to help avert or minimize potential disruptions during the period surrounding the century date change. Recently available information provided little evidence that the expansion in economic activity might be moderating from the vigorous pace of the past year, notably during the second half of 1999. While inflation had remained largely contained, there were mounting concerns that persisting growth in aggregate demand at a pace in excess of the rise in potential supply would foster a buildup of inflation-

ary pressures that would undermine the economy's long-lasting expansion. Against this background, an increasing number of Federal Reserve Banks proposed a  $\frac{1}{4}$  percentage point rise in the basic discount rate during January 2000, and on February 2 the Board approved outstanding requests from ten Banks for such an increase. This increase occurred in concert with a similar policy tightening move by the FOMC.

In subsequent weeks, incoming economic information continued to point to vigorous growth in aggregate demand, but inflationary pressures were still being held down by equally impressive gains in aggregate supply, abetted by further apparent acceleration in labor productivity. While the extent to which prospective growth in demand might exceed further expansion in the economy's output potential and the implications for inflation were subject to a considerable range of uncertainty, by late February concerns about the risks of rising inflation led three Federal Reserve Banks to request a further  $\frac{1}{4}$  percentage point increase in the discount rate and nearly all the Banks had joined in submitting that request by the third week of March. The pending actions to raise the basic discount rate to  $5\frac{1}{2}$  percent were approved by the Board on March 21 in conjunction with another  $\frac{1}{4}$  percentage point increase by the FOMC in the intended federal funds rate, to 6 percent.

The final changes for the year in both the basic discount rate and the intended federal funds rate—increases of  $\frac{1}{2}$  percentage point—were approved on May 16, 2000. A more forceful policy move of  $\frac{1}{2}$  percentage point, after a series of  $\frac{1}{4}$  percentage point increases initiated in August 1999, was deemed

desirable to contain what were seen as rising inflation pressures in the economy. In particular, the extraordinary and persisting strength of overall demand continued to exceed the rapid productivity-enhanced growth of potential supply, and there were attendant indications of growing pressures in already tight markets for labor and other resources. By early May, most of the Reserve Banks had pending proposals calling for increases of  $\frac{1}{4}$  percentage point in the basic rate, and by mid-May all the Banks had outstanding requests for a higher rate, including four Banks that were proposing  $\frac{1}{2}$  percentage point increases. The Banks with proposed increases of  $\frac{1}{4}$  percentage point revised them to  $\frac{1}{2}$  percentage point within a few days after the Board's decision on May 16.

*Mid-May through Year-End:  
No Further Changes in the Basic Rate*

In mid-June, one Federal Reserve Bank requested a further increase of  $\frac{1}{4}$  percentage point in the basic rate. After the latter was withdrawn in mid-July, there were no further proposals to change the rate until December, when seven Banks requested a  $\frac{1}{4}$  percentage point reduction. By around midyear, economic growth had begun to exhibit signs of some moderation from its exceptionally rapid and unsustainable pace of the previous year. Indications that the expansion was moderating accumulated gradually during the summer and into the autumn. Over the last few months of the year, the growing effects on business and consumer spending of tightening credit conditions, declining stock market prices, and rising energy costs, among other factors, led to substantial slowing in the expansion of aggregate final sales, including weakness in consumer purchases of durable goods and

business investment in capital equipment. Business efforts to pare inventories as sales slowed induced related cutbacks in manufacturing activity. Shortly after the turn of the year, on January 3, 2001, the Board and the FOMC approved  $\frac{1}{2}$  percentage point reductions in the basic discount rate and the intended level of the federal funds rate.

### Structure of Discount Rates

The basic discount rate is the rate normally charged on loans to depository institutions for short-term adjustment credit, while flexible, market-related rates generally apply on seasonal and extended credit. The flexible rates are calculated every two weeks in accordance with formulas that are approved by the Board. The rate on loans from the Special Liquidity Facility during the century date rollover period was 150 basis points above the target federal funds rate established by the FOMC.

The objective of the seasonal program is to help smaller institutions meet liquidity needs arising from a clear pattern of intra-yearly movements in their deposits and loans. Funds may be provided for periods longer than those permitted under adjustment credit. Since its introduction in early 1992, the flexible rate charged on seasonal credit has been closely aligned with short-term market rates; it is never less than the basic rate applicable to adjustment credit.

The purpose of extended credit is to assist depository institutions that are under sustained liquidity pressure and are not able to obtain funds from other sources. The rate for extended credit is 50 basis points higher than the rate for seasonal credit and is at least 50 basis points above the basic rate. In appropriate circumstances, the basic rate may be applied to extended-credit loans for up

to thirty days, but any further borrowings would be charged the flexible, market-related rate.

Exceptionally large adjustment-credit loans that arise from computer breakdowns or other operating problems not clearly beyond the reasonable control of the borrowing institution are assessed the highest rate applicable to any credit extended to depository institutions. No loans of this type were made during 2000.

The Special Liquidity Facility was established as a temporary program for lending to depository institutions during the period October 1, 1999, through April 7, 2000. This facility was intended to help ensure that depository institutions would have adequate liquidity in the period surrounding the century date change.

At the end of 2000 the structure of discount rates was as follows: a basic rate of 6 percent for short-term adjustment credit and rates of 6.45 percent for seasonal credit and 6.95 percent for extended credit. During 2000 the rate for seasonal credit ranged from a low of 5.55 percent to a high of 6.65 percent, that for extended credit from a low of 6.05 percent to a high of 7.15 percent, and that for SLF credit from a low of 6.50 percent to a high of 7 percent.

### Board Votes

Under the Federal Reserve Act, the boards of directors of the Federal Reserve Banks must establish rates on loans to depository institutions at least every fourteen days and must submit such rates to the Board of Governors for review and determination. The Reserve Banks also are required to submit requests on the same schedule to renew the formulas for calculating the rates on seasonal, extended, and SLF credit. Votes on the reestablishment of the for-

mulas for these flexible rates are not shown in this summary. All votes taken by the Board of Governors during 2000 were unanimous.

### *Votes on the Basic Discount Rate*

*February 2, 2000.* Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Kansas City, and San Francisco to increase the basic discount rate  $\frac{1}{4}$  percentage point, to  $5\frac{1}{4}$  percent.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.  
Votes against this action: None.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Minneapolis and Dallas, effective February 3 and 4, 2000, respectively.

*March 21, 2000.* Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, and San Francisco to increase the basic discount rate  $\frac{1}{4}$  percentage point, to  $5\frac{1}{2}$  percent.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.  
Votes against this action: None.

The Board approved similar actions taken by the directors of the Federal Reserve Banks of St. Louis and Dallas, effective March 22 and 23, 2000, respectively.

*May 16, 2000.* Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks

of Boston, Cleveland, Richmond, and San Francisco to increase the basic discount rate  $\frac{1}{2}$  percentage point, to 6 percent.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.  
Votes against this action: None.

The Board subsequently approved similar actions taken by the directors of

the Federal Reserve Banks of Atlanta, Chicago, Kansas City, and Dallas, effective May 17; by the directors of the Federal Reserve Bank of St. Louis, effective May 18; and by the directors of the Federal Reserve Banks of New York, Philadelphia, and Minneapolis, effective May 19, 2000. ■

## *Minutes of Federal Open Market Committee Meetings*

The policy actions of the Federal Open Market Committee, contained in the minutes of its meetings, are presented in the ANNUAL REPORT of the Board of Governors pursuant to the requirements of section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each policy action, and that it shall include in its annual report to the Congress a full account of such actions.

The minutes of the meetings contain the votes on the policy decisions made at those meetings as well as a résumé of the discussions that led to the decisions. The summary descriptions of economic and financial conditions are based on the information that was available to the Committee at the time of the meetings rather than on data as they may have been revised later.

Members of the Committee voting for a particular action may differ among themselves as to the reasons for their votes; in such cases, the range of their views is noted in the minutes. When members dissent from a decision, they are identified in the minutes along with a summary of the reasons for their dissent.

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as

the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market operations, the Federal Reserve Bank of New York operates under two sets of instructions from the Federal Open Market Committee: an Authorization for Domestic Open Market Operations and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, the Committee operates under an Authorization for Foreign Currency Operations, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations. These policy instruments are shown below in the form in which they were in effect at the beginning of 2000. Changes in the instruments during the year are reported in the minutes for the individual meetings.

### **Authorization for Domestic Open Market Operations**

**In Effect January 1, 2000**

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to



securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than \$12.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 90 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account.

(c) To sell U.S. Government securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 90 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding but that in no event shall be less than 1.0 percent per annum of the market value of the securities lent. The Federal Reserve Bank of New York shall apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 90 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

4. In order to help ensure the effective conduct of open market operations during the transition period surrounding the century date change, the Committee authorizes the Federal Reserve Bank of New York to sell options on repurchase agreements, reverse

repurchase agreements, and matched sale purchase transactions for exercise no later than January 2000.

## **Domestic Policy Directive**

### **In Effect January 1, 2000<sup>1</sup>**

The information reviewed at this meeting suggests continued strong expansion of economic activity. Nonfarm payroll employment increased substantially further in October and November, and the civilian unemployment rate stayed at 4.1 percent in November, its low for the year. Manufacturing output recorded sizable gains in October and November. Total retail sales rose appreciably over the two months. Housing activity has softened somewhat over recent months but has remained at a high level. Trends in orders suggest that business spending on capital equipment has increased further. The U.S. nominal trade deficit in goods and services rose in October from its average in the third quarter. Aggregate price increases have been smaller in the past two months, reflecting a flattening in energy prices; labor compensation rates have been rising more slowly than last year.

Most market interest rates are up somewhat since the meeting on November 16, 1999. Measures of share prices in equity markets have risen further over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has changed little over the period in relation to the currencies of a broad group of important U.S. trading partners.

M2 continued to grow at a moderate pace in November while M3 surged. For the year through November, M2 and M3 are estimated to have increased at rates somewhat above the Committee's annual ranges for 1999. Total domestic nonfinancial debt has expanded at a pace in the upper end of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed

at its meeting in June the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 2000, the Committee agreed on a tentative basis in June to retain the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1999 to the fourth quarter of 2000. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 5½ percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period.

## **Authorization for Foreign Currency Operations**

### **In Effect January 1, 2000**

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

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1. Adopted by the Committee at its meeting on December 21, 1999.

Canadian dollars  
Danish kroner  
euro  
Pounds sterling  
Japanese yen

Mexican pesos  
Norwegian kroner  
Swedish kronor  
Swiss francs

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding \$25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount (millions of dollars equivalent)
Bank of Canada .....	2,000
Bank of Mexico .....	3,000

Any changes in the terms of existing swap arrangements, and the proposed terms of any

new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies, or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in

the absence of members of the Board serving on the Subcommittee, other Board Members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account ("Manager"), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

## **Foreign Currency Directive**

In Effect January 1, 2000

1. System operations in foreign currencies shall generally be directed at countering dis-

orderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the IMF Article IV.

## **Procedural Instructions with Respect to Foreign Currency Operations**

In Effect January 1, 2000

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the

Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$300 million on any day or \$600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding \$150 million, or \$300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$1.5 billion

since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any operations that are not of a routine character.

### **Meeting Held on February 1–2, 2000**

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 1, 2000, at 2:30 p.m. and continued on Wednesday, February 2, 2000, at 9:00 a.m.

#### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broaddus  
Mr. Ferguson  
Mr. Gramlich  
Mr. Guynn  
Mr. Jordan  
Mr. Kelley  
Mr. Meyer  
Mr. Parry

Mr. Hoenig, Ms. Minehan,  
Messrs. Moskow and Poole,  
Alternate Members of the Federal  
Open Market Committee

Messrs. Boehne, McTeer, and Stern,  
Presidents of the Federal Reserve  
Banks of Philadelphia, Dallas, and  
Minneapolis respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Ms. Fox, Assistant Secretary  
Mr. Gillum, Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Baxter, Deputy General Counsel  
Ms. Johnson, Economist

Mr. Prell, Economist

Mr. Beebe, Ms. Cumming,  
Messrs. Eisenbeis, Goodfriend,  
Howard, Lindsey, Reinhart,  
Simpson, Sniderman, and  
Stockton, Associate Economists

Mr. Fisher, Manager, System Open  
Market Account

Mr. Winn,<sup>2</sup> Assistant to the Board,  
Office of Board Members,  
Board of Governors

Mr. Ettin, Deputy Director, Division of  
Research and Statistics, Board  
of Governors

Messrs. Madigan and Slifman,  
Associate Directors, Divisions  
of Monetary Affairs and Research  
and Statistics respectively, Board  
of Governors

Messrs. Oliner and Whitesell, Assistant  
Directors, Divisions of Research  
and Statistics and Monetary  
Affairs respectively, Board  
of Governors

Mr. Small,<sup>3</sup> Section Chief, Division  
of Monetary Affairs, Board of  
Governors

Messrs. Brayton,<sup>3</sup> Morton,<sup>4</sup> and  
Rosine,<sup>4</sup> Senior Economists,  
Divisions of Research and  
Statistics, International Finance,  
and Research and Statistics  
respectively, Board of Governors

Ms. Garrett and Mr. Hooker,<sup>4</sup>  
Economists, Division  
of Monetary Affairs, Board  
of Governors

Ms. Low, Open Market Secretariat  
Assistant, Division of Monetary  
Affairs, Board of Governors

Ms. Browne, Messrs. Hakkio  
and Hunter, Ms. Krieger,  
Messrs. Lang, Rasche, Rolnick,  
and Rosenblum, Senior Vice  
Presidents, Federal Reserve Banks  
of Boston, Kansas City, Chicago,  
New York, Philadelphia, St. Louis,  
Minneapolis, and Dallas  
respectively

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for the period commencing January 1, 2000, and ending December 31, 2000, had been received and that these individuals had executed their oaths of office.

The elected members and alternate members were as follows:

William J. McDonough, President of the Federal Reserve Bank of New York, with Jamie B. Stewart, Jr., First Vice President of the Federal Reserve Bank of New York, as alternate

J. Alfred Broadus, Jr., President of the Federal Reserve Bank of Richmond, with Cathy E. Minehan, President of the Federal Reserve Bank of Boston, as alternate

Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, with Michael H. Moskow, President of the Federal Reserve Bank of Chicago, as alternate

Jack Guynn, President of the Federal Reserve Bank of Atlanta, with William Poole, President of the Federal Reserve Bank of St. Louis, as alternate

Robert T. Parry, President of the Federal Reserve Bank of San Francisco, with Thomas M. Hoenig, President of the Federal Reserve Bank of Kansas City, as alternate

By unanimous vote, the following officers of the Federal Open Market

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2. Attended Tuesday's session only.

3. Attended portion of meeting relating to the staff presentation of policy alternatives.

4. Attended portion of meeting relating to the Committee's review of the economic outlook and consideration of its money and debt ranges for 2000.

Committee were elected to serve until the election of their successors at the first meeting of the Committee after December 31, 2000, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank they would cease to have any official connection with the Federal Open Market Committee:

Alan Greenspan	Chairman
William J. McDonough	Vice Chairman
Donald L. Kohn	Secretary and Economist
Normand R.V. Bernard	Deputy Secretary
Lynn S. Fox	Assistant Secretary
Gary P. Gillum	Assistant Secretary
J. Virgil Mattingly, Jr.	General Counsel
Thomas C. Baxter, Jr.	Deputy General Counsel
Karen H. Johnson	Economist
Michael J. Prell	Economist

Jack H. Beebe, Christine Cumming,  
Robert A. Eisenbeis, Marvin S.  
Goodfriend, David H. Howard,  
David E. Lindsey, Vincent R. Reinhart,  
Thomas D. Simpson, Mark S.  
Sniderman, and David J. Stockton,  
Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after December 31, 2000.

By unanimous vote, Peter R. Fisher was selected to serve at the pleasure of the Committee as Manager, System Open Market Account, on the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

*Secretary's note:* Advice subsequently was received that the selection of Mr. Fisher as Manager was satisfactory to the board

of directors of the Federal Reserve Bank of New York.

By unanimous vote, the Committee approved an addition to the Authorization for Domestic Open Market Operations regarding adjustments to the stance of monetary policy during intermeeting periods. As had previously been agreed, the temporary authority given to the Federal Reserve Bank of New York to sell options to counter potential century-data-change pressures in financial markets was allowed to lapse. Accordingly, the Authorization was adopted, effective February 1, 2000, as shown below.

### Authorization For Domestic Open Market Operations

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than \$12.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) To buy U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 90 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account.

(c) To sell U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 90 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding but that in no event shall be less than 1.0 percent per annum of the market value of the securities lent. The Federal Reserve Bank of New York shall apply reasonable limitations on the total amount of a specific issue that may be auctioned, and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve

Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 90 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

4. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat in exceptional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate. Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any adjustment.

With Mr. Broadus dissenting, the Authorization for Foreign Currency Operations and the Foreign Currency Directive were reaffirmed in the forms shown below.

### Authorization For Foreign Currency Operations

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market



Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Canadian dollars	Mexican pesos
Danish kroner	Norwegian kroner
Euro	Swedish kronor
Pounds sterling	Swiss francs
Japanese yen	

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding \$25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those

designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Bank of Canada .....	2,000
Bank of Mexico .....	3,000

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1A. above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies, or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). When appropriate in connection with arrangements to provide investment facili-

ties for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account ("Manager"), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors' Statement of Procedure with Respect to For-

eign Relationships of Federal Reserve Banks dated January 1, 1944.

## Foreign Currency Directive

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the IMF Article IV.

Mr. Broadus dissented in the votes on the Authorization and the Directive because they provide the foundation for foreign exchange market intervention. He continued to believe that the Federal Reserve's participation in foreign exchange market intervention compromises its ability to conduct monetary policy effectively. Because sterilized intervention cannot have sustained effects in the absence of conforming monetary policy actions, Federal Reserve partici-

pation in foreign exchange operations in his view risks one of two undesirable outcomes. First, the independence of monetary policy is jeopardized if the System adjusts its policy actions to support short-term foreign exchange objectives set by the U.S. Treasury. Alternatively, the credibility of monetary policy is damaged if the System does not follow interventions with compatible policy actions, the interventions consequently fail to achieve their objectives, and the System is associated in the mind of the public with the failed operations.

By unanimous vote, the Procedural Instructions with Respect to Foreign Currency Operations, in the form shown below, were reaffirmed.

### Procedural Instructions with Respect to Foreign Currency Operations

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$300 million on any day or \$600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding \$150 million, or \$300 million when the

operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in I.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System and about any operations that are not of a routine character.

On January 19, 2000, the continuing rules, regulations, and other instructions of the Committee were distributed with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention before the February 1–2 organization meeting to give members an opportunity to raise any questions they might have concerning them. Members were asked to indicate if they wished to have any of the instruments in question placed on the agenda for consideration at this meeting.

The Rules of Procedure were placed on the agenda and by unanimous vote the Committee approved updating changes, effective upon publication

in the *Federal Register*. The changes relate to electronic and telephone communications.

*Secretary's note:* The revised Rules of Procedure were published in the *Federal Register* on February 9, 2000.

By unanimous vote, the Program for Security of FOMC Information was amended with regard to certain security classifications and staff access to confidential FOMC information.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 21, 1999, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period December 21, 1999, to February 1, 2000. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 2000, and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that economic activity had expanded rapidly in recent months. Consumer spending had remained very brisk, business fixed investment had continued on a strong upward trend, and housing demand was still at a relatively high level despite some slippage recently. The growth of

domestic demand had been met in part through further advances in imports. Domestically, industrial production and nonfarm payrolls had continued to increase briskly. Despite very tight labor markets, labor costs had been climbing more slowly than in 1998. Consumer price inflation had stayed moderate over the past few months, despite a recent resurgence in energy prices.

Labor demand remained robust through year-end, as nonfarm payroll employment posted a further large increase in December. Job growth in the services industry was brisk, construction hiring rose somewhat further against a backdrop of good weather and project backlogs, and manufacturing employment was essentially unchanged. The civilian unemployment rate held at 4.1 percent in December, its low for the year, and initial claims for unemployment insurance persisted at a very low level through late January.

Industrial production recorded a sharp advance in the fourth quarter. Manufacturing and mining output rose briskly, but utilities output was held down by lackluster demand during a period of unseasonably warm weather in several parts of the country. Output gains in manufacturing were widespread and the factory operating rate rose further, though capacity utilization was still a little below its long-term average.

Consumer spending apparently was very robust in the fourth quarter. Total nominal retail sales rose sharply further in December, with outlets for durable and nondurable goods recording substantial gains in sales. Expenditures related to Y2K concerns appeared to have been relatively limited. Outlays for services in October and November (latest data) were strong, even though spending for heating was down in response to the unseasonably warm weather.

Housing activity was still at a relatively high level at year-end, buoyed by continuing strong gains in jobs and incomes despite the rise that had occurred in mortgage interest rates. Total private housing starts rebounded sharply in December from a decline in November, although part of the December pickup might have been associated with favorable weather patterns. Sales of new homes fell in November (latest data), reversing much of the sizable October rise, but average sales for the two-month period were only slightly below their strong rate of the first half of the year. Sales of existing homes were down in December, but they also were only a little below their elevated first-half pace.

The available information suggested that growth of business spending for durable equipment slowed abruptly in the fourth quarter and that investment in nonresidential structures fell further. At least some of the deceleration in spending for capital equipment reflected a hesitancy to spend on computers and other high-tech equipment just in advance of the century rollover. The weakness in the nonresidential sector was evidenced by further declines in construction outlays and new building contracts in October and November. Office construction appeared to be leveling off in response to the higher cost of financing and to perceptions that the office space currently coming on line would be sufficient to meet demand.

The book value of manufacturing and trade inventories surged in November after having climbed moderately on balance earlier in the year. Even though the rise might have been related to concerns about supply disruptions around year-end, inventory-sales ratios generally declined a little in association with very strong increases in sales, and the ratios were at or near the bottom of their ranges for the previous twelve months.

The U.S. trade deficit in goods and services widened significantly over the October–November period from its average for the third quarter. The value of exports rose appreciably over the two months, largely reflecting growth in industrial supplies and service receipts, but the value of imports increased noticeably more, with some of the rise reflecting increases in import prices. The available information suggested that economic expansion remained robust in most foreign industrial nations. In Japan, however, economic activity was sluggish, with a seemingly small rise in the fourth quarter following a third-quarter decline. Economic activity in the developing countries apparently continued to pick up in recent months, although the pace of recovery varied widely. Economic growth appeared to have been brisk in Mexico, Korea, China, Hong Kong, and Taiwan but was mixed among the ASEAN countries and slower in Brazil.

Price inflation had remained moderate in recent months. Consumer price inflation was subdued in December in spite of a sizable increase in energy prices; however, for the year as a whole, sharp increases in energy prices noticeably boosted overall consumer inflation. Excluding the volatile energy component, consumer price inflation slowed somewhat in 1999. By contrast, the subdued rise in the core PCE chain price index in 1999 was essentially the same as in 1998. At the producer level, prices of finished goods other than food and energy changed little in December and registered a considerably reduced increase in 1999. At earlier stages of processing, however, core producer prices recorded somewhat larger advances than those for finished goods in December and for the year. With regard to labor costs, average hourly earnings rose by a larger amount in

December than in November, but the increase in this measure in 1999 was about the same as for 1998.

At its meeting on December 21, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with an unchanged federal funds rate of about 5½ percent and that did not contain any bias relating to the direction of possible adjustments to policy during the intermeeting period. The members noted that such a directive, which suggested that they did not expect a further change in policy before the February meeting, should foster steady conditions in financial markets during the sensitive century-date-change period. The Committee also agreed, however, that the statement accompanying the announcement of its decision would note that the Committee was especially concerned about the potential for inflation pressures to increase and would want to consider at its February meeting whether policy action would be needed to contain such pressures.

Open market operations during the intermeeting period were directed toward maintaining the federal funds rate at around 5½ percent. The funds rate averaged close to the Committee's target over the intermeeting interval despite very strong demands for additional currency and market liquidity through the year-end and a rapid unwinding thereafter. Against the background of the Committee's announced concern about the inflationary implications of unsustainably rapid economic growth, incoming information suggesting that aggregate demand retained considerable momentum led to upward pressure on market interest rates once the century-date-change period had passed without incident. The effects of higher interest rates apparently offset those of unexpectedly high corporate

earnings, and most broad stock market indexes fell slightly on balance over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar was up on balance over the intermeeting interval in relation to indexes of major foreign currencies and those of other important U.S. trading partners. Reflecting market expectations of substantial Federal Reserve tightening, the dollar appreciated considerably against the yen and the euro while depreciating somewhat against the Canadian dollar.

M2 growth picked up appreciably during December and January, evidently reflecting extra demands for liquidity and safety during the century-date-change period. M3 accelerated by even more than M2 in December. Its non-M2 component ballooned as banks issued substantial volumes of large time deposits to meet very high credit demands and as institutional money market funds became recipients of some of their customers' precautionary liquid balances. From the fourth quarter of 1998 through the fourth quarter of 1999, M2 and M3 increased at rates somewhat above the Committee's annual ranges for 1999. Total domestic nonfinancial debt expanded in 1999 at a pace in the upper portion of its range.

The staff forecast prepared for this meeting suggested that the expansion would gradually moderate from its currently elevated pace to a rate around or perhaps a little below the growth of the economy's estimated potential. The expansion of domestic final demand increasingly would be held back by the anticipated waning of positive wealth effects associated with earlier large gains in equity prices and by higher interest rates. As a result, growth of spending on consumer durables and houses was expected to slow; in contrast, however, overall business invest-

ment in equipment and software was projected to strengthen in response to the upward trend in replacement demand, especially for computers and software; also, continued solid economic growth abroad was expected to boost the growth of U.S. exports for some period ahead. Core price inflation was projected to rise somewhat over the forecast horizon, partly as a result of higher import prices and some firming of gains in nominal labor compensation in persistently tight labor markets that would not be fully offset by productivity growth.

In the Committee's review of current and prospective economic developments, members commented that the economy still seemed to be growing very vigorously as it entered the new year, while core inflation remained subdued. The members were concerned, however, that recent trends in economic activity, if they continued, might undermine the economy's remarkable performance. The economy's potential to produce goods and services had been accelerating over time, but the demand for output had been growing even more strongly. If this imbalance continued, inflationary pressures were likely to build that would interfere with the economy's performance and could lead to a disruptive adjustment in economic activity. Accelerating productivity, although adding to the growth of the economy's potential output, also had induced expectations of rapidly accelerating business earnings that in turn had generated sharp increases in stock market wealth and lifted the growth of purchasing power and spending above that in incomes. Relatively high real interest rates that reflected the increased productivity and damped the rise in asset values would be needed to help restore balance. In that regard, members questioned whether rates

would be high enough without policy tightening to bring the growth of demand in line with that of supply and contain pressures in labor markets. In the view of some members, taut labor markets together with a turnaround in some of the factors that had been temporarily damping inflation, such as oil and import prices, already lent an upward bias to the inflation outlook, and all agreed that a significant further tightening of labor resource utilization would appreciably raise the risk of deterioration in the underlying inflation picture over time.

In keeping with the practice at meetings preceding the Federal Reserve's semiannual report to Congress on the economy and monetary policy and the Chairman's associated testimony, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared individual projections of the growth in nominal and real GDP, the rate of unemployment, and the rate of inflation for the year 2000. The forecasts of the growth of nominal GDP were concentrated in a range of  $5\frac{1}{4}$  to  $5\frac{1}{2}$  percent, and for the rate of expansion in real GDP they had a central tendency of  $3\frac{1}{2}$  to  $3\frac{3}{4}$  percent. Growth at these rates was expected to hold the civilian unemployment rate in a range of 4 to  $4\frac{1}{4}$  percent in the fourth quarter of 2000. The central tendency of the projections of inflation for 2000—as measured by the chain price index for personal consumption expenditures—encompassed a range of  $1\frac{3}{4}$  to 2 percent, on the low side of the 2 percent rise in this index experienced in 1999 when energy prices had surged.

Mirroring developments in the overall economy, reports of economic conditions in the individual Federal Reserve districts continued to display broad-based strength, apart from softness in

construction activity in some areas and weakness in agriculture. Retail sales appeared to have strengthened further during the opening weeks of the new year after a surge during the holiday season. Motor vehicle sales in particular had continued to hold up at a remarkably high level. Consumption was being supported by robust growth in jobs and incomes, very high levels of consumer confidence, and the lagged wealth effects from earlier advances in stock market prices. Even so, growth in consumer spending was thought likely to moderate over time to a pace more in line with the expansion in consumer incomes, unless the stock market posted large further increases from current levels. As the experience of recent years had amply demonstrated, however, the future course of stock market prices was highly uncertain, and equity markets had shown a remarkable resilience to higher interest rates as earning prospects continued to be marked up in association with the acceleration in productivity.

Opportunities to enhance profits by using new technology were likely to lead to robust further growth in business fixed investment, boosted mainly by spending for equipment and software over the year ahead. While the huge amount of capital deepening already accomplished in recent years and the projected deceleration in aggregate demand were negative factors in the outlook for business capital spending, they were likely to be overridden by persisting declines in the prices of high-tech equipment and the rising importance of replacement demand that was associated with relatively short-lived investments in high-tech equipment and computer software that had tended to characterize the buildup in business equipment in recent years. With regard to other types of investment, spending on nonresidential business structures appeared to be

softening in many areas and would tend to hold down the growth in overall business expenditures for capital. However, spending by state and local governments on roadbuilding and other projects appeared to be on a robust uptrend.

Housing construction was expected to remain at a relatively elevated level, albeit below recent peaks, as a consequence of moderating demand stemming from higher mortgage interest rates and indications of overbuilding in some areas. Members also noted, however, that building activity in some parts of the country was still being held back by shortages of skilled construction workers and scarcities of some building supplies. The resulting backlogs along with low inventories of houses in some areas were factors that should limit the expected decline in residential construction this year. Moreover, many homebuyers were shifting from fixed-rate long-term mortgages to currently lower-cost adjustable rate mortgages. More fundamentally, however, the income and wealth effects that were boosting household expenditures generally should help to sustain a perhaps somewhat diminished but still high level of homebuilding activity for a while, despite higher mortgage financing costs.

Rapid increases in U.S. exports in conjunction with the strengthening of foreign economies were likely to add to demands on domestic producers. Consistent with this outlook, several members cited anecdotal reports of improving foreign markets, notably in East Asian countries. At the same time, despite some expected deceleration in imports as domestic demand moderated, the nation's trade deficit was projected to increase somewhat further over the year ahead. There was a risk that, as global portfolios came to be increasingly weighted toward dollar assets, expected returns on those assets would



need to rise to attract world savings, with much of the adjustment potentially occurring through a decline in the exchange rate of the dollar that would add to pressures on U.S. prices.

Concerning the outlook for inflation, the members continued to see the risks as primarily tilted toward rising inflationary pressures, though they anticipated that further gains in productivity would hold down increases in unit labor costs and prices, at least over the nearer term. A key issue was whether growth in aggregate demand would moderate sufficiently to at least avoid greater pressures on what were already very tight labor markets. In this regard, several cited recent statistical and anecdotal evidence of larger increases in labor compensation, although unit labor costs did not appear to be trending higher at this point. However, some nonlabor input prices already were rising faster. The prospects for energy prices were very difficult to predict, but even if such prices were to stabilize, the passthrough of the large earlier increases into inflation and wage expectations, as well as into the prices of products that were heavily energy dependent, was likely to exert some upward pressure on prices throughout the economy.

On the positive side for the near-term inflation outlook, there was no evidence that the acceleration in productivity was coming to an end. Members commented in this regard that business firms across the country were continuing to improve the efficiency of their operations in a variety of ways in order to hold down costs. These efforts included persistingly large investments in new equipment, rationalization of business organizations, and training or retraining existing workers for more demanding or new tasks. Members also noted that longer-run inflation expectations generally did not appear to be worsening, though there

had been a slight widening of the spread between nominal and inflation-indexed Treasury bond yields. While there seemed to be an increasing number of exceptions, business contacts continued to report that raising their prices was very difficult to carry out successfully and often impossible. On balance, the outlook for inflation remained subject to a marked degree of uncertainty. Given current levels of resource use and the strength of the economic expansion relative to the growth of the economy's long-run potential, however, the members expected that inflation pressures would gather some momentum over time unless financial conditions became tighter.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee reviewed at this meeting the ranges for growth of the monetary and debt ranges that it had established on a tentative basis in June 1999. The tentative ranges approved in June for the period from the fourth quarter of 1999 to the fourth quarter of 2000 included growth of 1 to 5 percent for M2, 2 to 6 percent for M3, and 3 to 7 percent for total domestic nonfinancial debt.

All but one of the members favored the adoption of the ranges that had been selected on a tentative basis at the meeting in June. They noted that for some years the ranges for monetary growth had been chosen to encompass rates of increase that would be expected under conditions of price stability, assuming historical velocity relationships. This approach had been adopted partly as a result of the substantial unreliability of the linkage between the growth of the broad monetary aggregates and economic performance. Since the current benchmark ranges had first been adopted in the mid-1990s, however, structural

productivity growth had increased substantially, raising the expected rate of growth of money at price stability, other things equal. One member supported a proposal to adjust the monetary growth ranges upward by at least enough to reflect this development. However, other members emphasized the uncertainties about the dimensions of this new trend in productivity growth, the measured rate of increase in prices that would be consistent with reasonable price stability, and the long-run behavior of velocity. They felt that raising the benchmark ranges risked misleading the public about the Committee's confidence in the implied values for these variables going forward, about the Committee's determination to pursue its fundamental objectives of price stability and sustainable economic expansion, and about the very low weight most Committee members continued to place on the monetary aggregates in policy deliberations owing to the uncertainties surrounding them.

At the conclusion of this discussion, the Committee voted to approve without change the ranges for 2000 that it had established on a tentative basis on June 30, 1999. With Mr. Meyer dissenting, the following statement of longer-run policy and growth ranges for 2000 was approved for inclusion in the domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1999 to the fourth quarter of 2000. The range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities and

developments in prices, the economy, and financial markets.

Votes for this action: Messrs. Greenspan, McDonough, Broadbent, Ferguson, Gramlich, Gwynn, Jordan, Kelley, and Parry.  
Vote against this action: Mr. Meyer.

In dissenting, Mr. Meyer noted that although the money growth ranges do not play an important role in the conduct of monetary policy today, the Congress has mandated that the FOMC set and report ranges for money and credit growth. In recent years, the money ranges have been set to be consistent with price stability and normal velocity behavior. The rate of money growth consistent with price stability depends on the average growth of real GDP. Therefore, when there is a significant increase in the projected average growth rate in real GDP, money growth ranges should be adjusted upward so that they remain consistent with price stability. While considerable uncertainty remains about the average rate of growth in real GDP, there is a strong consensus that it is significantly higher today than when the target ranges were set at their current values. The failure to adjust monetary aggregate ranges makes them less useful signals of Federal Reserve intentions. As long as the Federal Reserve is required to set and report ranges for money and debt growth, it should update them as appropriate.

In the Committee's discussion of policy for the upcoming intermeeting period, all the members supported a proposal to tighten reserve conditions by a modest amount consistent with an increase in the federal funds rate of  $\frac{1}{4}$  percentage point to a level of  $5\frac{3}{4}$  percent. The Committee's decision to tighten its policy stance was intended to help bring the growth of aggregate demand into better alignment with the expansion of sustainable aggregate sup-

ply in an effort to avert rising inflationary pressures in the economy. Relatively high real interest rates would be required to accomplish this objective, given the effects of increasing productivity and profits on the demand for capital goods and, through the wealth effect, on consumption spending. Private long-term rates already had risen considerably, but whether they had reached a level that would lead to a rebalancing of demand and supply was an open question. Moreover, these rates already encompassed expectations of a tightening of monetary policy at this and several subsequent meetings. For a number of reasons, including uncertainties about the outlook for the expansion of aggregate demand in relation to that of potential supply, the economy's response to the Committee's earlier policy actions, and the recently somewhat unsettled conditions in financial markets, a majority of the members expressed a preference for a limited policy move at this time. As long as inflation and inflation expectations remained damped, these members saw little risk in a gradual approach to policy tightening and considerable advantage to preserving the possibility of calibrating those actions to the emerging situation. A few members expressed a preference for an increase of 50 basis points in the federal funds rate in order to provide greater assurance against a buildup of inflationary expectations and inflation over coming months. Other members acknowledged that the Committee might need to move more aggressively at a later meeting should imbalances continue to build and inflation and inflation expectations clearly begin to pick up.

The members agreed that the statement to be issued after this meeting should highlight their view that even

after their firming today the risks remained weighted mainly in the direction of rising inflation pressures. There were few signs thus far that the rise in interest rates over recent quarters was restraining demand in line with potential supply, and the members generally agreed that further tightening actions might well be needed to ensure that financial conditions had adjusted sufficiently to rising productivity growth to forestall escalating pressures on labor costs and prices. With the cushion of unutilized labor resources having dwindled over recent years and with the willingness of global investors to continue to acquire dollar assets to finance major further increases in imports at current interest and exchange rates in question, the need to achieve the appropriate financial and economic balance had become more pressing. In the circumstances, it was important for the public to understand that the Committee saw inflation risks as persisting even after today's action. At the conclusion of this discussion, members who favored a 50 basis point increase indicated that, in light of the clear intention of the Committee to act, if necessary, in a timely manner to contain inflation, the contemplated inclusion of a statement about the risks of higher inflation in the press release for this meeting, and the likelihood that the Board of Governors would approve a 25 basis point increase in the discount rate later in the day, they could accept a 25 basis point rise in the federal funds rate.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following policy directive:

To further the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around  $5\frac{3}{4}$  percent.

The vote also encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes the risks are weighted mainly toward conditions that may generate heightened inflation pressures in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Broaddus, Ferguson, Gramlich, Guynn, Jordan, Kelley, Meyer, and Parry. Votes against this action: None.

The meeting was recessed briefly after this vote, and the members of the Board of Governors left the room to vote on pending increases in the discount rate at several Federal Reserve Banks. On the Board members' return, Chairman Greenspan announced that the Board had approved a  $\frac{1}{4}$  percentage point increase in the discount rate. The Committee concluded its meeting with a review of the press release announcing the joint policy action.

The members noted with deep regret the recent death of Frank E. Morris, former president of the Federal Reserve Bank of Boston and a member of the Committee over the course of twenty years before his retirement at the end of 1988. Mr. Morris is remembered as a highly respected colleague and friend who made outstanding contributions to the work of the Committee, the Federal Reserve Bank of Boston, and the Federal Reserve System more generally.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 21, 2000.

The meeting adjourned at 11:50 a.m. on February 2, 2000.

Donald L. Kohn  
Secretary

### **Meeting Held on March 21, 2000**

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, March 21, 2000, at 9:00 a.m.

#### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broaddus  
Mr. Ferguson  
Mr. Gramlich  
Mr. Guynn  
Mr. Jordan  
Mr. Kelley  
Mr. Meyer  
Mr. Parry

Mr. Hoenig, Ms. Minehan,  
Messrs. Moskow, Poole, and  
Stewart, Alternate Members of the  
Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern,  
Presidents of the Federal Reserve  
Banks of Philadelphia,  
Dallas, and Minneapolis  
respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Ms. Fox, Assistant Secretary  
Mr. Gillum, Assistant Secretary  
Mr. Mattingly, General Counsel  
Ms. Johnson, Economist  
Mr. Prell, Economist

Ms. Cumming, Messrs. Eisenbeis,  
Goodfriend, Howard, Lindsey,  
Reinhart, Simpson, and Stockton,  
Associate Economists

- Mr. Fisher, Manager, System Open Market Account
- Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors
- Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
- Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
- Messrs. Struckmeyer and Whitesell, Assistant Directors, Divisions of Research and Statistics and Monetary Affairs respectively, Board of Governors
- Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors
- Ms. Browne, Messrs. Hakkio and Hunter, Ms. Krieger, Messrs. Lang, Rasche, and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Chicago, New York, Philadelphia, St. Louis, and Dallas respectively
- Mr. Bryan, Assistant Vice President, Federal Reserve Bank of Cleveland
- Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis
- Mr. Rudebusch, Senior Research Officer, Federal Reserve Bank of San Francisco

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on February 1–2, 2000, were approved.

The Manager of the System Open Market Account reported on recent

developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period February 2, 2000, through March 20, 2000. By unanimous vote, the Committee ratified these transactions.

At its meeting in August 1999, the Committee had voted to expand the collateral that could be accepted in System repurchase transactions and had authorized the use of reverse repurchase agreements. These authorizations were scheduled to expire at the end of April 2000. At this meeting the Manager proposed that the authority to use the broader range of collateral be extended until the first meeting in 2001 and that the authority to engage in reverse repurchase agreements be made permanent.

The principal effect of the expanded collateral authorized last August, together with the use of triparty repurchase agreements, was to allow pass-through mortgage securities of GNMA, FNMA, and FHLMC and "stripped" securities of the U.S. Treasury and federal government agencies to be taken as collateral for repurchase transactions. Direct Treasury obligations remained the preferred means for meeting the System's needs, but anticipated paydowns of marketable federal debt associated with projected budget surpluses were likely to limit the System's ability in the future to continue to add substantially to holdings, even on a temporary basis, without generating undesirable market repercussions.

In this setting, the Manager recommended that a broad-gauge study be undertaken to consider alternative asset classes and selection criteria that could be appropriate for the System Open Market Account (SOMA), with particular attention to alternatives to the current reliance on net additions to outright holdings of Treasury securities as the sole means of effectuating the upward trend in the asset side of the System's balance sheet.

Pending the completion of that study and the Committee's consideration of alternative asset allocations, the Manager suggested that the Desk could rely on temporary operations with relatively long maturities to meet the growth in underlying reserve needs that could not comfortably be met by further outright purchases of Treasury securities. In implementing these temporary operations, the Manager expressed a preference to distribute the System's demand for collateral as broadly as possible in order to minimize the impact on spread relationships in the financing market. This preference motivated his recommendation to extend temporarily the authority to operate in the broader range of collateral.

The required size of the longer-term temporary operations would depend on how much of the permanent reserve need could be met by outright purchases of Treasury securities. The Manager noted that the desirability of maintaining a liquid bill portfolio suggested that System holdings of any bill issue should be limited to 35–40 percent of the outstanding amount. With issue sizes declining, such limits might mean that from time to time some portion of the System's maturing bill holdings would be redeemed rather than rolled over in Treasury auctions. The Manager also intended to roll over maturing holdings of Treasury coupon issues in auctions

and to add to the System's portfolio to meet permanent reserve needs by purchasing coupon securities in the secondary market. However, the amount that could be added through outright purchases without disturbing the Treasury market would have to be gauged over time relative to conditions in the market as Treasury issuance patterns evolved in response to System purchases and Treasury buybacks of coupon securities.

All the members endorsed the proposal for a study of the issues associated with the System's asset allocation in light of declining Treasury debt. They noted that the requested temporary expansion of authority, pending the Committee's consideration of the completed study, should not be read as indicating in any way how the Committee might ultimately choose to allocate the portfolio, and any interim operations in the broader range of collateral should be capable of being unwound without adverse market consequences.

At the conclusion of this discussion, the Committee voted unanimously to extend the suspension of several provisions of the "Guidelines for the Conduct of System Operations in Federal Agency Issues" until the first regularly scheduled meeting in 2001.

The Committee also accepted a proposal by the Manager to make permanent the authority to use reverse repurchase agreements in the conduct of open market operations. Such agreements are equivalent to matched sale–purchase transactions, which the Manager has long been authorized to use, but reverse RPs have the advantage of much greater flexibility because they are the common practice in financial markets. The Manager indicated that he did not expect to use reverse RPs on a regular basis until the System's new trading system became operational, but in conjunction with existing triparty arrangements there

might be occasions in the interim when the timing of open market operations would make it desirable to use them instead of matched sale–purchase transactions. The members voted unanimously to adopt on a permanent basis, subject to the annual review required for all the Committee’s instruments, paragraph 1(c) of the Authorization for Domestic Open Market Operations in the form reproduced below.

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(c) To sell U.S. Government securities and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 90 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that the expansion of economic activity remained rapid. Consumer spending and business fixed investment were still trending upward strongly, and housing demand was holding at a high level. Although the growth in domestic demand was being met partly through rising imports, industrial production and nonfarm payrolls were expanding briskly. Labor markets continued to be very tight, but there were few signs of any acceleration in labor costs. Price inflation was still moderate,

except for the upturn in energy prices in recent months.

Labor demand remained robust in January and February, with the average increase in private nonfarm payroll employment over the two months only a little below the strong pace of 1999. Job growth in manufacturing and construction was solid, while hiring in the services sector slowed appreciably. The civilian unemployment rate, at 4.1 percent in February, was just above its 1999 low, and initial claims for unemployment insurance were at an extremely low level in early March.

Industrial production was up sharply in the early months of the year, reflecting large gains in the manufacturing and utilities sectors. Within manufacturing, output of high-tech equipment was notably strong, but production of motor vehicles and parts also recorded a sizable advance on balance over the January–February period. By contrast, output of aircraft and parts weakened again. The continuing strength in manufacturing lifted the factory operating rate further, but capacity utilization stayed a little below its long-term average.

Retail sales continued to increase rapidly in January and February against the backdrop of strong growth in disposable income and household wealth and elevated consumer confidence. Sales of light vehicles surged over the January–February period. Purchases of goods other than motor vehicles picked up substantially further, with gains widespread across most major categories. Outlays for services rose briskly in January (latest data); part of the gain resulted from higher spending for heating as temperatures in many parts of the country dropped to more seasonable levels.

Residential housing activity remained strong in the first two months of the year. Total private housing starts in January and February held at the high

December level, as a surge in starts of multifamily units offset a downturn in starts of single-family homes. The demand for housing, associated with continuing gains in jobs and incomes, had remained ebullient despite an appreciable increase in mortgage rates. Although sales of new single-family homes fell in January (latest data), the decline followed a December pace that was the highest monthly rate in more than twenty years. Sales of existing homes also declined in January, continuing a trend that had begun last July, but inventories of existing homes for sale evidently were at very low levels.

Business spending on durable equipment and software and on nonresidential structures increased sharply in January. Shipments of computing and communications equipment surged after the century rollover, and shipments of other non-aircraft goods rose moderately. Deliveries of aircraft continued to be held down by the labor strike at Boeing. The recent strength in orders for many types of equipment pointed to further advances in spending in coming months. Expenditures for nonresidential structures turned up last autumn and rose rapidly in January. Office and other commercial construction activity was robust, while industrial building was little changed.

The pace of accumulation of manufacturing and trade inventories slowed somewhat in January from the elevated rate in the fourth quarter; however, sales grew briskly and the aggregate inventory-sales ratio edged down from an already very low level. In manufacturing, stocks increased moderately further in January; however, shipments grew more, and the aggregate stock-shipments ratio for the sector declined to a new low. Both wholesale and retail inventories increased in line with sales, and inventory-sales ratios

for these sectors stayed at the bottom of their respective ranges over the past twelve months.

The U.S. trade deficit in goods and services climbed to a new high in January, as the value of exports retreated from the peak reached in December and the value of imports rose sharply. The drop in exports was concentrated in computers, semiconductors, aircraft, chemicals, and consumer goods, while the increase in imports was primarily in oil and automotive products. The available information suggested that economic expansion continued to be robust in most foreign industrial economies. The Japanese economy was still the notable exception, though some favorable signs were evident. Economic activity in the developing countries also picked up further, with Asian countries registering the largest gains.

Price inflation had remained moderate in recent months, with the exception of higher energy prices. Consumer prices jumped in February as energy prices surged. Abstracting from energy prices, however, consumer price inflation was moderate in January and February. Moreover, the increase in consumer prices of items other than food and energy during the twelve months ended in February was the same as the change during the previous twelve-month period. At the producer level, prices of finished goods other than food and energy changed little in January and February, and their rise during the twelve months ended in February was somewhat smaller than the advance during the previous twelve-month period. At earlier stages of processing, however, producer prices registered somewhat larger increases than those for finished goods in both the January-February period and the twelve months ended in February. With regard to labor costs, average hourly earnings grew at a



slightly faster rate in January and February than they had in the fourth quarter of last year. However, the advance in this earnings measure in the twelve months ended in February was about the same as that in the previous twelve-month period.

At its meeting on February 1–2, 2000, the Committee adopted a directive that called for a slight tightening of conditions in reserve markets consistent with an increase of  $\frac{1}{4}$  percentage point in the federal funds rate to an average of about  $5\frac{3}{4}$  percent. The members agreed that this action was needed to help bring the growth of aggregate demand into better alignment with the expansion of potential aggregate supply and thereby help avert rising inflationary pressures. The members also agreed that the risks remained weighted mainly in the direction of greater inflation pressures and that further tightening actions might be necessary to bring about financial conditions that were sufficiently firm to contain upward pressures on labor costs and prices.

Open market operations during the intermeeting period were directed toward implementing the desired slightly greater pressure on reserve positions, and the federal funds rate averaged very close to the Committee's  $5\frac{3}{4}$  percent target. The Committee's action and its announcement that the risks were weighted in the direction of rising inflation were widely anticipated and had little immediate effect on market yields. Subsequently, market rates moved up in response to the receipt of data that signaled persisting strength of the economy, but they turned back down in response to new information indicating continued low inflation and to greater volatility in equity prices. On balance over the intermeeting period, interest rates on private instruments registered small mixed changes while yields on

longer-term Treasury securities declined significantly. Most major indexes of equity prices moved up appreciably on net over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar changed little over the intermeeting period against a basket of major currencies. The dollar rose against the Australian dollar, British pound, Canadian dollar, and the euro as investors apparently revised down their expectations of the extent of monetary tightening in those countries. By contrast, the dollar declined against the Japanese yen and the currencies of a number of other important trading partners, notably the Mexican peso and the Brazilian real.

The growth of M2 and M3 slowed in February, partly reflecting an unwinding of Y2K effects and rising opportunity costs of holding liquid balances. In addition, the surging prices of technology-related equities might have spurred depositors to shift some of their M2 balances into equity mutual funds. The growth of total domestic nonfinancial debt slowed early in the year as large federal debt paydowns resumed following the sharp buildup of Treasury balances before year-end.

The staff forecast prepared for this meeting suggested that the economic expansion would moderate gradually from its currently elevated pace to a rate around, or perhaps a little below, the growth of the economy's estimated potential. The expansion of domestic final demand increasingly would be held back by the anticipated waning of positive wealth effects associated with large earlier gains in equity prices and by higher interest rates. As a result, the growth of spending on consumer durables and houses was expected to slow; in addition, business investment in equipment and software was projected to decelerate following a first-quarter

surge that partly reflected information technology expenditures that had been postponed until after the century roll-over. In addition, solid economic expansion abroad was expected to boost the growth of U.S. exports for some period ahead. Core price inflation was projected to increase somewhat over the forecast horizon, partly as a result of rising import prices and some firming of gains in nominal labor compensation in persistently tight labor markets that would not be fully offset by productivity growth.

In the Committee's discussion of current and prospective economic developments, members commented, as they had at earlier meetings, that they saw little evidence of any slowing in the rapid expansion of domestic economic activity, but they also saw few signs to date of significant acceleration in inflation. The growth in aggregate demand continued to display remarkable vigor, evidently driven by high levels of consumer and business confidence and accommodative financial markets. Large increases in imports were helping to satisfy the impressive growth in demand. At the same time, aggregate supply also continued to record strong gains amid indications of further acceleration in productivity. Looking ahead, however, members reiterated earlier concerns that aggregate demand could continue to grow faster than potential aggregate supply, even under optimistic assumptions regarding future productivity gains. Contributing to that continuing imbalance, the strengthening of most foreign industrial economies and the diminishing effects of the earlier appreciation of the dollar were likely to boost further foreign demand for U.S. output. The experience of recent years amply demonstrated, however, that the extent to which prospective growth in demand might exceed further expansion in the

economy's potential and the implications for inflation were subject to a wide range of uncertainty as to both degree and timing. Nonetheless, given the persistence of rapid growth in aggregate demand beyond growth in aggregate supply and very tight conditions in labor markets, the members continued to be concerned about the risks of rising inflation.

In their comments about economic conditions across the nation, members referred to anecdotal and other evidence of widespread strength in business activity, which in many areas appeared to be rising appreciably further from already high levels. Agriculture continued to be a notable exception, though members also reported signs of softening in housing and other construction activity in some areas. With regard to developments in key sectors of the economy, consumer spending had remained particularly robust thus far this year according to reports from most parts of the nation. Some moderation in such spending to a pace more in line with the growth in household incomes was cited as a reasonable expectation, given underlying factors such as the large buildup of durable goods in consumer hands, the rise in consumer debt loads, and the effects of higher oil prices. Of key importance was the prospective performance of the stock market, whose robust gains in recent years had undoubtedly boosted consumer confidence and spending. The members noted that equity prices generally had posted further gains during the intermeeting period, but in their view the large increases of recent years were not likely to be repeated, and an absence of such gains would have a restraining effect on consumer expenditures over time. Even so, further increases in household incomes along with the lagged wealth effects of the sharp earlier

advances in stock market prices seemed likely to sustain relatively strong consumer spending for some period of time.

After having moderated toward the end of 1999, in part because of caution ahead of the century date change, business fixed investment again appeared to be expanding at a vigorous pace. The advance included not only notable strength in the high-tech sector but brisk spending in a number of other areas as well. Factors underlying business optimism included robust growth in revenues and profits and the ready availability of both debt and equity financing. The divergence, at least until recently, in the stock market between the valuations of high-tech firms and those of more traditional, established firms was inducing a redirection of investment funds to business activities that were perceived to be more productive. While the associated capital investments undoubtedly had contributed to the acceleration in productivity, some members expressed concern that the historically elevated valuations of many high-tech stocks were subject to a sizable market adjustment at some point. That risk was underscored by the increased volatility of the stock market.

In the housing sector, building activity generally remained at a high level, though slipping a bit in some parts of the country, and there were only limited indications that the rise in mortgage interest rates was holding down residential construction. On the other hand, housing and other construction activity reportedly was being retarded by shortages of labor and, in some areas, of materials as well. On balance, recent developments did not augur any significant changes in homebuilding.

The improved economic outlook for most of the nation's important trading partners, in association with the fading effects of the dollar's earlier apprecia-

tion, pointed to faster expansion in exports, and recent anecdotal reports were broadly consistent with such a development. Growth in imports was expected to moderate over time, though imports currently were still rising rapidly. Even so, prospective developments in the foreign trade sector were not likely to provide much relief to demand pressures on the U.S. economy.

With regard to the outlook for inflation, members saw little evidence to date of any acceleration in core inflation, and unit costs for nonfinancial corporations were unchanged in the fourth quarter. Despite such welcome developments, members expressed concern about indications of a less benign inflation climate. The direct and indirect effects of higher fuel prices, the rise in other import prices, increasing medical costs, and some deterioration in surveys of inflation expectations could begin to show through to higher underlying inflation. More fundamentally, however, the members believed that current growth in aggregate demand, should it persist, would continue to exceed the expansion of potential output and, by putting added pressure on already tight labor markets, would at some point foster inflationary imbalances that would undermine the economic expansion.

In the Committee's discussion of policy for the intermeeting period ahead, all the members endorsed a proposal to tighten reserve conditions by a slight amount consistent with an increase in the federal funds rate to a level of 6 percent. Persisting strength in aggregate domestic demand had been accommodated thus far without a pickup in underlying inflation because of the remarkable acceleration in productivity and because of two safety valves—the economy's ability to draw on the pool of available workers and to finance the rapid growth in imports relative to

exports. However, a further acceleration in productivity was unlikely to boost the economy's growth potential sufficiently to satisfy the expansion in aggregate demand without some slowing in the latter. In addition, the two safety valves could not be counted on to work indefinitely. In these circumstances, the members saw substantial risks of rising pressures on labor and other resources and of higher inflation that called for some further firming of monetary policy at this meeting. They agreed, though, that because a significant acceleration in inflation did not appear to be imminent and because uncertainties continued to surround the economic outlook, a gradual approach to policy adjustments was warranted. Some members commented that, although a more forceful policy move of 50 basis points might be needed at some point, measured and predictable policy tightening moves, such as the one contemplated today, still were desirable in current circumstances, which included somewhat unsettled financial markets.

Looking ahead, the Committee would continue to assess the need for further tightening to contain inflation. Even after taking account of the lagged effects of the considerable tightening that already had been implemented since mid-1999, additional tightening might well be needed to ensure that financial conditions would adjust sufficiently to bring aggregate demand into better balance with potential supply and thereby counter a possible escalation of pressures on labor costs and prices. The members agreed that the press statement to be issued shortly after this meeting should continue to highlight their view that even after today's tightening move the risks would remain tilted toward heightened inflation pressures.

At the conclusion of this discussion, the Committee voted to authorize and

direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System account in accordance with the following policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 6 percent.

The vote also encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes the risks are weighted mainly toward conditions that may generate heightened inflation pressures in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Broadus, Ferguson, Gramlich, Guynn, Jordan, Kelley, Meyer, and Parry. Votes against this action: None.

The meeting was recessed briefly after this vote, and the members of the Board of Governors left the room to vote on increases in the discount rate that were pending at several Federal Reserve Banks. On the Board members' return, Chairman Greenspan announced that the Board had approved a  $\frac{1}{4}$  percentage point increase in the discount rate to a level of  $5\frac{1}{2}$  percent. The Committee concluded its meeting with a review of the press release announcing the joint policy action.

It was agreed that the next meeting of the Committee would be held on Tuesday, May 16, 2000.

The meeting adjourned at 12:50 p.m.

Donald L. Kohn  
Secretary

## Meeting Held on May 16, 2000

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, May 16, 2000, at 9:00 a.m.

### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broaddus  
Mr. Ferguson  
Mr. Gramlich  
Mr. Guynn  
Mr. Jordan  
Mr. Kelley  
Mr. Meyer  
Mr. Parry

Mr. Hoenig, Ms. Minehan,  
Messrs. Moskow and Poole,  
Alternate Members of the Federal  
Open Market Committee

Messrs. McTeer and Stern, Presidents  
of the Federal Reserve Banks  
of Dallas and Minneapolis  
respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Ms. Fox, Assistant Secretary  
Mr. Gillum, Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Baxter, Deputy General Counsel  
Ms. Johnson, Economist  
Mr. Prell, Economist

Mr. Beebe, Ms. Cumming,  
Messrs. Eisenbeis, Howard,  
Lindsey, Reinhart, Simpson,  
Sniderman, and Stockton,  
Associate Economists

Mr. Fisher, Manager, System Open  
Market Account

Mr. Winn, Assistant to the Board,  
Office of Board Members,  
Board of Governors

Mr. Ettin, Deputy Director, Division  
of Research and Statistics,  
Board of Governors

Messrs. Madigan and Slifman,  
Associate Directors, Divisions  
of Monetary Affairs and Research  
and Statistics respectively, Board  
of Governors

Messrs. Oliner and Whitesell, Assistant  
Directors, Divisions of Research  
and Statistics and Monetary  
Affairs respectively, Board  
of Governors

Ms. Low, Open Market Secretariat  
Assistant, Division of Monetary  
Affairs, Board of Governors

Messrs. Rives and Stone, First Vice  
Presidents, Federal Reserve Banks  
of St. Louis and Philadelphia  
respectively

Messrs. Hakkio, Hunter, Lacker, Lang,  
Rasche, Rolnick, and Rosenblum,  
Senior Vice Presidents, Federal  
Reserve Banks of Kansas City,  
Chicago, Richmond, Philadelphia,  
St. Louis, Minneapolis, and Dallas  
respectively

Messrs. Bentley and Kopcke,  
Vice Presidents, Federal Reserve  
Banks of New York and  
Boston respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 21, 2000, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period March 21, 2000, through May 15, 2000. The Committee ratified these transactions by unanimous vote.

With Mr. Broadus dissenting, the Committee voted to extend for one year beginning in mid-December 2000 the reciprocal currency (“swap”) arrangements with the Bank of Canada and the Bank of Mexico. The arrangement with the Bank of Canada is in the amount of \$2 billion equivalent and that with the Bank of Mexico in the amount of \$3 billion equivalent. Both arrangements are associated with the Federal Reserve’s participation in the North American Framework Agreement, which was established in 1994. Mr. Broadus dissented because he believed that the swap lines existed primarily to facilitate foreign exchange market intervention, and he was opposed to such intervention for the reasons he had expressed at the February meeting.

The Manager discussed some aspects of a suggested approach to the management of the System’s portfolio over coming quarters prior to the Committee’s receipt and review of an ongoing study relating to the conduct of open market operations in a period of substantial declines in outstanding Treasury debt. During that interim, the management of the System portfolio should try to satisfy a number of objectives: keeping the maturity of the portfolio from lengthening materially; meeting long-run reserve needs to the extent possible through outright purchases of Treasury securities without distorting the yield curve or impairing the liquidity of the market; and concentrating expansion of the System portfolio in “off-the-run”

securities in the secondary market to help to maintain liquid markets in benchmark securities. It was important to announce a strategy that would allow market participants to take the System’s operations into account as they adapted to the declining Treasury debt levels. While no specific blueprint could be given at this point regarding future Desk operations, the members encouraged the Manager to discuss his plans with Treasury officials.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that economic growth had remained rapid through early spring. Consumer spending and business fixed investment were still trending upward strongly, and housing demand was holding at a high level. Industrial production and nonfarm payrolls were expanding briskly in response to burgeoning domestic demand, but the strength of demand was also showing through in the form of rising imports. Labor markets continued to be very tight, and some measures of labor costs and price inflation showed signs that they might be picking up.

Employment surged in March and April. Part of the pickup resulted from a step-up in government hiring of census workers, but gains in private employment were very large over the two months. Job growth in retail trade and services was robust, and employment in manufacturing and construction trended higher. The civilian unemployment rate dropped in April to 3.9 percent, a thirty-year low.

Industrial production accelerated in April after a strong gain in the first quarter. Manufacturing, notably in high-tech industries, led the way, but growth

in mining and utilities also was sizable. The pickup in manufacturing lifted the factory operating rate further, and capacity utilization in April was about equal to its long-term average.

Consumer spending increased very rapidly in the first quarter but apparently decelerated early in the second quarter. Nominal retail sales were down slightly in April after brisk gains in February and March. Sales slumped at durable goods stores and changed little at non-durable goods outlets. However, the underlying trend in spending remained strong as a result of robust expansion of disposable incomes, the large accumulated gains in household wealth, and very positive consumer sentiment.

Residential housing activity stayed at an elevated level in April; total private housing starts edged higher while starts of multifamily units partially reversed a sharp drop in March. Sales of both new and existing single-family homes rose in March (latest data). The persisting strong demand for housing during a period of rising mortgage rates apparently was being underpinned by the rapid growth of jobs and the accumulated gains in stock market wealth.

Business fixed investment was up sharply in the first quarter after a sluggish performance late last year. The pickup encompassed both durable equipment and software and nonresidential structures. Shipments of computing and communications equipment surged following the century rollover, and shipments of other non-aircraft capital goods recorded an unusually large rise as well. Moreover, the recent strength in orders for many types of equipment pointed to further advances in capital spending in coming months. Expenditures for non-residential structures, which had turned up last autumn, rose rapidly in the first quarter; unusually favorable weather over the two quarters likely was a con-

tributing factor. The upturn in nonresidential building activity was spread broadly across the major types of structures.

The pace of accumulation of manufacturing and trade inventories slowed somewhat in the first quarter following a sizable buildup in late 1999, and the aggregate inventory-sales ratio edged down from an already very low level. Stockbuilding by manufacturers and merchant wholesalers picked up slightly in the first quarter, but stocks remained at low levels in relation to sales. By contrast, inventory investment slowed among retailers. Part of this slowdown might have involved a liquidation of precautionary stocks built up in anticipation of the century date change. The inventory-sales ratio in this sector was at a historically lean level.

The U.S. trade deficit in goods and services reached another new high in February as the value of imports rose sharply further and the value of exports changed little. For the January-February period, the moderate rise in exports and the sharp increase in imports from fourth-quarter levels were spread across most major trade categories. The available information suggested that economic expansion remained robust in most foreign industrial economies. The recent decline in the exchange value of the euro was spurring economic activity in the euro area, and Canada was benefiting from spillovers from the U.S. economy. For the Japanese economy, which had been the notable exception among the foreign industrial economies, there were indications of some strengthening of aggregate demand during the first five months of the year. Economic activity in the developing countries also continued to pick up. Key South American countries were recovering from recent recessions, while several Asian emerging-market coun-

tries were settling into growth at more sustainable rates.

Recent information suggested that price inflation might be picking up slightly and only partly as a direct result of increases in energy prices. Although consumer prices were unchanged in April, they recorded sizable step-ups in February and March; moreover, while the rise in core consumer prices over the twelve months ended in April was the same as the change in the year-earlier twelve-month period, core consumer price inflation was up slightly in the March–April period compared with other recent months. At the producer level, prices of finished goods other than food and energy edged higher in March and April, but the increase over the twelve months ended in February was a little smaller than the rise over the preceding twelve months. With regard to labor costs, the employment cost index for hourly compensation of private industry workers registered a larger advance in the first quarter than in previous quarters, and the rate of increase in compensation over the year ended in March was substantially larger than the rise over the year-earlier period. Faster growth in benefits accounted for more than half of the acceleration. Average hourly earnings of production or non-supervisory workers grew at a slightly faster rate in April than in March, and the increase for the twelve months ended in April was larger than for the previous twelve-month period.

At its meeting on March 21, 2000, the Committee adopted a directive that called for a slight tightening of conditions in reserve markets consistent with an increase of  $\frac{1}{4}$  percentage point in the federal funds rate to an average of about 6 percent. The members saw substantial risks of rising pressures on labor and other resources and of higher inflation, and they agreed that the tightening

action would help bring the growth of aggregate demand into better alignment with the sustainable expansion of aggregate supply. They also noted that even with this additional firming the risks were still weighted mainly in the direction of rising inflation pressures and that more tightening might be needed.

Open market operations during the intermeeting period were directed toward implementing the desired slightly tighter pressure on reserve positions, and the federal funds rate averaged very close to the Committee's 6 percent target. The Committee's action and its announcement were widely anticipated and had little initial effect on financial markets. Later in the week, however, market interest rates moved up in response to the release of the minutes of the February meeting and the mention therein of some sentiment for a larger policy tightening than had been undertaken. Subsequently, interest rates fell as stock prices tumbled over the first half of April, when investors seemed to revise downward their assessments of equity valuations, especially those of more speculative technology shares that previously had risen considerably. Interest rates more than reversed those declines, however, when stock prices began to level out and incoming data suggested that aggregate demand continued to expand faster than potential supply and that wage and price developments were becoming more worrisome. On balance over the intermeeting period, private interest rates moved up appreciably while Treasury yields increased somewhat less. Most major indexes of equity prices declined significantly over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar appreciated considerably over the intermeeting period against a basket of major currencies, reflecting in part the larger



intermeeting increase in U.S. long-term yields relative to rates in most foreign industrial countries. The dollar's rise against the euro was sizable, but the dollar also made moderate gains against the British pound, the Japanese yen, and the Canadian dollar. The dollar also appreciated somewhat against the currencies of a group of other important trading partners, notably the Mexican peso and the Brazilian *real*.

Growth of M2 picked up further in April from its already strong pace in March, as households boosted their liquid balances to meet higher-than-usual levels of final payments on 1999 taxes. In contrast, M3 growth slowed considerably in April after a robust March advance. From the fourth quarter of 1999 through April, M2 and M3 expanded at rates well above the upper ends of their annual ranges for 2000. Total domestic nonfinancial debt continued to expand at a pace in the upper portion of its range.

The staff forecast prepared for this meeting continued to suggest that the expansion would gradually moderate from its currently elevated pace to a rate around, or perhaps a little below, the growth of the economy's estimated potential. The expansion of domestic final demand increasingly would be held back by the anticipated waning of positive wealth effects associated with earlier large gains in equity prices and by higher interest rates. As a result, the growth of spending on consumer durables and houses was expected to slow; in contrast, however, overall business investment in equipment and software was projected to remain robust, partly because of the upward trend in replacement demand, especially for computers and software. In addition, continued solid economic growth abroad was expected to boost the growth of U.S. exports for some period ahead. Core

price inflation was projected to rise noticeably over the forecast horizon, partly as a result of higher import prices and some firming of gains in nominal labor compensation in persistently tight labor markets that would not be fully offset by productivity growth.

In the Committee's review of current and prospective economic and financial developments, members focused on persisting indications that aggregate demand was expanding more rapidly than potential supply and that pressures on labor and other producer resources were continuing to increase. While there were tentative signs that the growth of demand might be moderating in some key sectors of the economy, such as retail sales and housing, clear-cut evidence of any significant deceleration in the rapid growth of aggregate demand was lacking. Bond yields and other financial conditions had firmed to some extent recently, but those adjustments had been influenced by the buildup in market expectations of more monetary policy tightening. In the absence of further monetary restraint, any slowing over coming quarters was not viewed as likely to be sufficient to avert increasing pressures on the economy's already strained resources and rising inflation rates that would undermine the economy's remarkable performance. Adding to concerns about heightened inflation pressures was statistical and anecdotal evidence that could be read as suggesting that underlying inflation already was beginning to pick up. Unit costs, however, were still remarkably subdued, and members saw no developments at this stage that might augur a sharp near-term deterioration in price inflation.

In their assessment of business conditions across the country, members commented on continuing indications of robust economic activity in all regions and widely increasing pressures on labor

and other resources. Indeed, economic activity appeared to have grown appreciably further from already elevated levels in numerous parts of the country, although the latest regional data and anecdotal reports provided scattered indications that business conditions might be starting to soften in some areas. In this regard, members referred to the emergence of slightly more cautious attitudes on the part of some business executives concerning the prospects for their industries.

With respect to developments in key expenditure sectors of the economy, growth in consumer spending was expected to slow from the exceptional pace of the first quarter, though still likely to be relatively robust. Retail sales had edged lower in April, but members commented that it was too early to gauge whether this softening was a harbinger of a more moderate trend. Consumer sentiment had remained upbeat in the context of an extended period of sizable expansion in employment and incomes and the sharp rise in stock market prices over the course of recent years. Some members observed that the slightly less ebullient consumer behavior recently might have been influenced to some extent by the volatility and downward movement in the stock market over the course of the past several weeks. Higher financing costs probably were also beginning to play a role. Looking ahead, the experience of recent years amply demonstrated the difficulty of forecasting the performance of the stock market. The failure of further large increases to materialize, should that occur, would over time imply a more neutral or even a negative net impact from wealth once the positive effects of the earlier advance had played themselves out, but the latter would take some time.

The same background factors were likely to govern the prospective behavior of housing activity. The evidence of a downturn in homebuilding was still quite marginal, but some anecdotal reports suggested that higher mortgage rates were starting to exert a retarding influence on housing demand. Even so, members continued to identify areas of remarkable strength across the nation, and overall housing construction remained at an elevated level. On the assumption of further growth in jobs and incomes in line with current forecasts and absent markedly higher mortgage financing costs, housing activity might reasonably be expected to settle at a level a bit below recent highs.

Business investment spending retained strong upward momentum, though it had exhibited an uneven growth pattern in recent quarters that importantly reflected Y2K effects. Looking ahead, further rapid growth was expected in spending for business equipment and software in light of likely ongoing efforts to hold down costs by substituting capital embodying advanced technology for scarce labor resources. Recent order trends and rising capacity utilization rates were consistent with this expectation. Expenditures on nonresidential structures and other construction generally had strengthened in recent months, and members expected them to be well maintained in part because of heavy spending on roads and other public projects by state and local governments.

The foreign trade sector of the economy was projected to provide less of a safety valve for the accommodation of domestic demand going forward. Although a number of foreign nations continued to face political and economic problems, the strengthening economies of many U.S. trading partners would tend to limit the availability of excess

foreign production capacity to help meet the growth in U.S. demand. At the same time, foreign demand for U.S. goods and services would be expanding, thereby adding to demand pressures on U.S. producer resources, other things equal. In the latter regard, several members mentioned anecdotal evidence of growing export demand for a variety of domestic products.

In their discussion of the outlook for inflation, the members focused on statistical and anecdotal indications of further tightening of labor resources, acceleration in some measures of labor compensation, and early signs of a possible upturn in underlying price inflation. Data on employment, reinforced by anecdotal commentary from around the country, continued to provide evidence of extremely tight labor markets, which at least in some parts of the country appeared to have tightened further since early in the year. Business contacts spoke of spending a great deal of time and expense to attract and retain workers while concomitantly persisting in efforts to improve the productivity of their operations to accommodate burgeoning growth in demand in the face of labor force constraints. There were more reports that rising wages and benefits and increasing costs of nonlabor inputs could no longer be fully offset by improvements in productivity, and more business firms appeared to be attempting or considering increases in their selling prices to maintain or improve their profit margins. However, their ability to set higher prices, or at least to raise them significantly, continued to be severely constrained by the persistence of strong competition across much of the economy. Indeed, examples of successful efforts to mark up prices, which tended to be concentrated in products using oil-related inputs, were still the exception. Even so, the members

believed that the risks of acceleration in core prices were now appreciably higher given current trends in aggregate demand, pressures on resources, and developments in foreign economies.

In the Committee's discussion of policy for the intermeeting period ahead, all the members endorsed a proposal to tighten reserve conditions sufficiently to raise the federal funds rate by  $\frac{1}{2}$  percentage point to a level of  $6\frac{1}{2}$  percent. A more forceful policy move than the 25 basis point increases that had been implemented since mid-1999 was desirable in light of the extraordinary and persisting strength of overall demand, exceeding even the increasingly rapid growth of potential supply, and the attendant indications of growing pressures in already tight markets for labor and other resources. The strength in demand might itself be, at least in part, the result of the ongoing acceleration of productivity, with the latter feeding back on demand through higher equity prices and profitable investment opportunities. Financial markets seemed to have recognized the need for real interest rates to rise further under these circumstances, and while market assessments were not always correct, the evidence suggested that a more substantial tightening at this meeting was needed to limit inflation pressures. The members saw little risk in a relatively aggressive policy move, given the strong momentum of the expansion and widespread market expectations of such a move. The greater risk to the economic expansion at this point was for policy to be too sluggish in adjusting, thereby allowing inflationary disturbances and dislocations to build. A 50 basis point adjustment was more likely to help forestall a rise in inflationary expectations that, at least in the opinion of some members, already showed signs of worsening. A widespread view that the Federal

Reserve would take whatever steps were needed to hold down inflation over time probably had contributed to the persistence of subdued long-run inflation expectations during an extended period when rapidly rising demand was pressing on limited supply resources. Today's policy move would undergird such relatively benign expectations and help ensure the success of the Committee's policy.

The members agreed that the balance of risks sentence that would be included in the press statement to be released shortly after this meeting should indicate, as it had for other recent meetings, that even after today's tightening action the members believed the risks would remain tilted toward rising inflation. This view of the risks was based primarily on the persisting momentum of aggregate demand growth and the unusually high level of labor resource utilization. At the same time, a number of the members commented that they did not want to prejudge the potential extent or pace of future policy tightening and that the Committee should continue to assess the need for further policy moves in the light of evolving economic conditions to be reviewed on a meeting-by-meeting basis.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 6½ percent.

The vote also encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes the risks are weighted mainly toward conditions that may generate heightened inflation pressure in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Broadus, Ferguson, Gramlich, Guynn, Jordan, Kelley, Meyer, and Parry. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, June 27–28, 2000.

The meeting adjourned at 1:05 p.m.

Donald L. Kohn  
Secretary

### **Meeting Held on June 27–28, 2000**

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, June 27, 2000, at 2:30 p.m. and continued on Wednesday, June 28, 2000, at 9:00 a.m.

#### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broadus  
Mr. Ferguson  
Mr. Gramlich  
Mr. Guynn  
Mr. Jordan  
Mr. Kelley  
Mr. Meyer  
Mr. Parry

Mr. Hoenig, Ms. Minehan,  
Messrs. Moskow and Poole,  
Alternate Members of the Federal  
Open Market Committee

Messrs. McTeer and Stern, Presidents of the Federal Reserve Banks of Dallas and Minneapolis respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Ms. Fox, Assistant Secretary  
Mr. Gillum, Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Baxter, Deputy General Counsel  
Ms. Johnson, Economist  
Mr. Stockton, Economist

Ms. Cumming, Messrs. Eisenbeis, Goodfriend, Howard, Lindsey, Reinhart, and Simpson, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Porter,<sup>5</sup> Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Messrs. Freeman,<sup>6</sup> Oliner,<sup>7</sup> Struckmeyer, Whitesell, and Ms. Zickler,<sup>6</sup> Assistant Directors, Divisions of International Finance, Research and Statistics, Monetary Affairs, and Research and Statistics respectively, Board of Governors

Mr. Reifschneider,<sup>5</sup> Section Chief, Division of Research and Statistics, Board of Governors

Mr. Bomfim<sup>6</sup> and Ms. Garrett, Economists, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Pianalto and Mr. Stone, First Vice Presidents, Federal Reserve Banks of Cleveland and Philadelphia respectively

Messrs. Hakkio, Hunter, Lang, Rasche, and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of Kansas City, Chicago, Philadelphia, St. Louis, and Dallas respectively

Messrs. Altig, Fuhrer, Judd, Ms. Perelmuter, and Mr. Weber, Vice Presidents, Federal Reserve Banks of Cleveland, Boston, San Francisco, New York, and Minneapolis respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 16, 2000, were approved.

By unanimous vote, David J. Stockton was elected to serve as economist until the election of his successor at the first meeting of the Committee after December 31, 2000, with the understanding that in the event of the discontinuance of his official connection with the Board of Governors he would cease to have any official connection with the Federal Open Market Committee.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the Sys-

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5. Attended portion of meeting relating to the Committee's discussion of the economic outlook.

6. Attended portion of meeting relating to the Committee's longrun policy.

7. Attended Wednesday session only.

tem's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period May 16, 2000, through June 27, 2000. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that the economic expansion was moderating somewhat from a very rapid pace in the first quarter. Consumer spending was increasing only modestly after large gains earlier, housing activity was down somewhat, and growth of business spending on capital equipment, while still quite vigorous, was slowing a little after a first-quarter surge. As a consequence, industrial production and employment were rising at somewhat reduced rates. Core consumer prices continued to evidence some acceleration, to an important extent reflecting some indirect effects of the sharp increase in oil prices over the past year.

Nonfarm payroll employment increased further in May, although the rise was associated with a surge in government hiring of census workers that more than offset a considerable contraction in private payrolls. The drop in private employment following very large gains in March and April seemed, in the absence of other signs of weakening labor demand, to be attributable at least to some extent to statistical noise and seasonal adjustment problems. Averaging over the three months, private nonfarm employment advanced at about the rate of the previous twelve

months. The civilian unemployment rate averaged 4.0 percent over April and May.

Industrial production continued to rise in May after a brisk increase in April, but the average gain for April and May was somewhat below the average monthly advance during the two previous quarters. Manufacturing output climbed at a slower rate in the April–May period, reflecting less rapid growth in the production of high-tech equipment and sluggish output of other non-automotive equipment. The further step-up in manufacturing activity lifted capacity utilization a little further, bringing it still closer to its long-term average.

Growth of consumer spending apparently slowed considerably in the second quarter after outsized gains in several previous quarters. Nominal retail sales declined in both April and May; outlays fell at durable goods outlets and edged up at nondurable goods stores. Despite the recent weakness, however, continued solid expansion of disposable incomes, the large accumulated gains in household wealth, and very positive consumer sentiment suggested that underlying fundamentals behind household spending remained favorable.

Higher mortgage rates apparently were exerting a restraining effect on residential housing activity. Total private housing starts fell in May to their lowest level since the middle of last year. Moreover, while sales of new single-family homes had not yet slackened appreciably through April (latest data), sales of existing homes through May were running below their 1999 average. In addition, consumers' assessments of homebuying conditions and builders' ratings of new home sales had weakened significantly.

Business fixed investment appeared to be on track for another rapid increase

in the second quarter. Shipments of non-defense capital goods, notably computing and communications equipment, continued on a strong uptrend in May, and the persisting strength in orders for many types of equipment pointed to further advances in coming months. Outlays for nonresidential structures, which had been weak in 1999, rose sharply in the first quarter and recorded a further appreciable gain in April.

The book value of manufacturing and trade inventories increased in April at about the first-quarter pace. Stockbuilding was generally in line with sales, and aggregate inventory-sales ratios for the manufacturing, wholesale, and retail sectors remained near the bottom of their ranges for the preceding twelve months. There were few indications across industries of significant inventory imbalances.

The U.S. trade deficit in goods and services for April was very close to its March level. However, the deficit was up appreciably from its average for the first quarter, with the value of imports increasing substantially more than the value of exports. The available information indicated robust economic growth in all major regions of the world thus far this year. Economic activity in the foreign industrial countries expanded vigorously in the first quarter, and growth generally appeared to be continuing at a strong pace in the second quarter. In addition, the available information suggested that a number of emerging-market economies had registered very rapid expansion thus far this year.

Recent information continued to indicate that consumer price inflation had picked up, while producer price inflation was essentially unchanged. Consumer prices edged up in May after having been unchanged in April; excluding the food and energy components, consumer prices rose moderately further in May.

For the twelve months ended in May, both total and core consumer prices increased somewhat more than in the previous twelve-month period. At the producer level, prices of finished goods other than food and energy edged higher in April and May and rose during the twelve months ended in May by the same moderate amount recorded for the previous twelve-month period. With regard to labor costs, average hourly earnings of production or nonsupervisory workers registered only a slight increase in May after a somewhat larger rise in April. The advance for the twelve months ended in April was about the same as that for the previous twelve-month period.

At its meeting on May 16, 2000, the Committee adopted a directive that called for a tightening of conditions in reserve markets sufficient to raise the federal funds rate  $\frac{1}{2}$  percentage point, to a level of  $6\frac{1}{2}$  percent. The members noted that the relatively forceful move was necessary given the persisting growth of aggregate demand in excess of the expansion of potential supply, which was creating rising pressures in already tight markets for labor and other resources. In their view, this action would help bring aggregate demand into better alignment over time with potential supply and thereby work to forestall the emergence of inflationary expectations and the buildup of inflationary pressures. They also noted that even with this additional firming, the risks were still weighted mainly in the direction of rising inflationary pressures.

Open market operations during the intermeeting period were directed toward implementing the desired increased pressure on reserve positions, and the federal funds rate averaged very close to the Committee's  $6\frac{1}{2}$  percent target. The Committee's action and its announcement surprised markets only a

little, and bond and stock prices edged a bit lower. Markets grew increasingly uneasy over the next few weeks as incoming data suggested the possible need for further substantial policy tightening, which could have adverse effects on corporate earnings. These concerns apparently contributed to sharp further declines in equity prices and to widening risk spreads on corporate bonds. Subsequently, debt and equity markets rebounded in response to a series of U.S. economic data releases that were viewed as signaling a moderation in aggregate demand and a continuation of limited cost and price pressures, and thus a reduced probability of additional monetary tightening. On balance over the intermeeting interval, yields on longer-term Treasury securities and investment-grade corporate bonds declined appreciably, and most broad stock price indexes ended the period little changed.

In foreign exchange markets, the trade-weighted value of the dollar depreciated somewhat over the intermeeting period against an index of major currencies. Decreases in longer-term U.S. interest rates weighed on the dollar, and the dollar's decline against the euro also occurred against the background of indicators of accelerating activity in the euro area and possible further monetary tightening. Frequent hints that the Bank of Japan might abandon its zero policy rate might have contributed to the dollar's weakness against the yen. By contrast, the dollar strengthened a little against the currencies of a group of other important trading partners, notably the currencies of Mexico, Indonesia, and the Philippines.

M2 and M3 appeared to have rebounded in June following the clearing in May of unusually large final personal tax payments for 1999. The expansion of these aggregates likely had been held down somewhat this year by slug-

gish currency growth in the aftermath of the century date change and by the increase in the opportunity cost of their liquid components associated with rising market interest rates. Nevertheless, supported by rapid growth in nominal spending and income, M2 evidently had expanded over the first half of the year at a rate close to that in 1999, and M3 had expanded at a faster rate than last year. Strong demands for bank credit, funded by the issuance of large time deposits and other liabilities not included in M2, underlaid the acceleration in M3.

The staff forecast prepared for this meeting continued to suggest that the economic expansion would moderate gradually from its currently elevated pace to a rate around or perhaps a little below the growth of the economy's estimated potential. The expansion of domestic final demand increasingly would be held back by the anticipated waning of positive wealth effects associated with earlier large gains in equity prices and by higher interest rates; as a result, growth of spending on consumer durables and houses was expected to slow further. By contrast, business fixed investment, notably purchases of equipment and software, was projected to remain robust, and continued solid economic growth abroad would boost the growth of U.S. exports for some period ahead. Core price inflation was projected to rise noticeably over the forecast horizon, partly as a result of higher import prices and some firming of gains in nominal labor compensation in persistently tight labor markets that would not be fully offset by productivity growth.

In the Committee's discussion of current and prospective economic developments, members cited evidence of slower expansion in economic activity in recent months. In particular, consumer spending had decelerated notice-



ably, especially for housing and motor vehicles, but the members agreed that the eventual extent and duration of the slowing in overall economic growth were subject to substantial uncertainty. A number of factors supported a projection of considerably more moderate expansion going forward in relation to the overly rapid pace in the second half of 1999 and early 2000, including the likelihood that much of the effect on spending of the rise in interest rates and leveling out in equity prices this year had not yet been felt. Nevertheless, the indications of slowing economic expansion were still tentative. Some sectors of the economy, such as business fixed investment, continued to display substantial vigor, and the members could not be confident that growth would not rebound to a clearly unsustainable pace, as had occurred previously in this expansion. With regard to inflation, members observed that steep increases in energy prices had boosted overall rates of inflation somewhat, and in addition the higher energy prices likely had contributed indirectly to the rise in core measures of inflation. A number of members also were concerned that rising core inflation could be generated increasingly from unsustainably tight labor markets, and they noted that labor costs would need to be monitored closely even if growth in demand slowed sufficiently to keep levels of resource utilization about unchanged. To date, however, rising productivity growth had contained labor cost pressures, and despite the moderation in the expansion of activity, there were no early signs of any slowing in the growth of productivity.

In preparation for a report to Congress, the members of the Board of Governors and the presidents of the Federal Reserve Banks provided individual projections of the growth of nominal and

real GDP, the rate of unemployment, and the rate of inflation for the years 2000 and 2001. With regard to the growth of nominal GDP, most of the forecasts were in ranges of  $6\frac{1}{4}$  to  $6\frac{3}{4}$  percent for 2000 as a whole and  $5\frac{1}{2}$  to 6 percent for 2001. The forecasts of the rate of expansion in real GDP had a central tendency of 4 to  $4\frac{1}{2}$  percent for 2000, suggesting a noticeable deceleration in the second half of the year, and were centered on a range of  $3\frac{1}{4}$  to  $3\frac{3}{4}$  percent for 2001. The civilian rates of unemployment associated with these forecasts had central tendencies of about 4 percent in the fourth quarter of 2000 and 4 to  $4\frac{1}{4}$  percent in the fourth quarter of 2001. Forecasts of the rate of inflation were shaped importantly by the projected pattern of energy prices; for this year the forecasts, as measured by the chain-type price index for personal consumption expenditures, were centered on a range of  $2\frac{1}{2}$  to  $2\frac{3}{4}$  percent before dropping back to a range of 2 to  $2\frac{1}{2}$  percent in 2001.

In their assessment of business conditions in different parts of the country, the presidents of the Federal Reserve Banks commented on indications of some slowing in the expansion of regional economic activity in a majority of the districts, though several emphasized that the available information pointed to only slight moderation to date. This slowing and the cumulative effects of the firming in financial conditions this year had been accompanied by an increasing number of anecdotal reports of more cautious business sentiment.

In their comments on developments in key sectors of the economy nationwide, the members reported on statistical and anecdotal indications that growth in consumer spending had slowed appreciably in recent months from the unusually robust pace seen in

late 1999 and early this year. A number of factors that might account for the moderation could also point to the possible extension of the less robust trend. Those factors included gradually waning wealth effects associated with the absence of further large gains in stock market prices; rising levels of consumer debt; the loss of consumer purchasing power stemming from higher energy prices; and the large cumulative buildup of consumer stocks of motor vehicles and other durables. Still, the data on retail sales were volatile and often revised significantly; some of the recent moderation in spending might have reflected a pause following the surge in demand during atypically favorable weather conditions over the winter months; and the pace of purchases could pick up again. While the course of consumer spending remained uncertain, members concluded that, in the context of relatively high levels of consumer confidence and sizable projected gains in jobs and incomes, slower but still solid expansion in consumer expenditures was most likely to occur over coming quarters.

The housing market also provided clear evidence of weakening demand. The slowdown evidently reflected the effects of higher mortgage interest rates on a growing number of homebuyers and probably also the diminishing wealth effects of the earlier run-up in stock prices and the cumulatively large additions to the stock of housing in the economy. The sluggish tone of the housing data was confirmed by anecdotal reports of slowing residential sales and building activity in most parts of the country. Despite these developments, sizable building backlogs in many areas, the outlook for continuing growth in consumer incomes, and still favorable consumer sentiment were likely to support substantial homebuilding activity,

albeit at a reduced level. At least in some parts of the country, firms supplying building materials and home furnishings were beginning to feel the retarding effects of the slowdown in the housing market.

After a surge early in the year that evidently reflected in part investment spending delayed by Y2K concerns, growth in business fixed investment had moderated in recent months but was expected to remain quite robust over the next several quarters. New orders for many types of business equipment had remained strong, order backlogs had continued to build, and it was clear that business executives still anticipated high rates of return on their new investments. As a result, business investment spending could be expected to remain elevated, at least over the nearer term and especially for high-tech equipment and software. At the same time, members cited anecdotal indications of the emergence of a more cautious tone in the business community, evidently associated in part with less favorable financial conditions in debt and equity markets and possibly auguring more substantial cutbacks in business investment over time should growth in personal consumption outlays be sustained on a considerably slower trend.

Strengthening economic activity in many of the nations that are important U.S. trading partners was reflected in expanding exports, and several members provided anecdotal confirmation of growing foreign markets for many U.S. goods and services. While expanding export markets were a welcome development from the perspective of many domestic businesses, they would add to overall demand pressures on U.S. producer resources at a time when the latter were already operating at very high levels.

With regard to the outlook for inflation, members gave considerable attention to the somewhat faster increases in broad price measures over the past year, but they differed to some extent regarding the prospects for further increases in inflation. It was generally agreed that developments relating to energy would continue to exert upward pressure on prices over the near term, including the pass-through or indirect effects of higher oil prices on core measures of inflation. Looking beyond the near term, a number of members, noting that core measures of consumer prices had been rising more rapidly this year, were concerned that these prices might well continue to accelerate gradually, even assuming that economic expansion would be sustained at a pace close to the economy's potential. In this view, labor markets were already operating at levels of utilization that were likely eventually to produce rising labor costs that would be passed through to market prices even if productivity growth remained high or rose somewhat further. Other members were more optimistic that core inflation might be contained near current levels. The recent increase in core inflation could largely reflect the indirect effects of the rise in energy prices. To date, unit labor costs had been quite subdued, leaving open the question of what was a sustainable level of labor resource use. Rising productivity was likely to continue to restrain unit labor costs to a degree, and product markets remained highly competitive. However, even these members saw considerable inflation risks should the slowdown in aggregate demand fail to be sustained, and the members generally agreed that for the foreseeable future possible increases in underlying inflation remained the principal risk to the continued good performance of the U.S. economy.

In contrast to its earlier practice, the Committee at this meeting did not establish ranges for growth of money and debt in 2000 and 2001. The legal requirement to set and announce such ranges recently had expired, and the members did not view the ranges as currently serving a useful role in the formulation of monetary policy. Owing to uncertainties about the behavior of the velocities of money and debt, these ranges had not provided reliable benchmarks for the conduct of monetary policy for some years. Nevertheless, the Committee believed that the behavior of these aggregates retained value for gauging economic and financial conditions and that such behavior should continue to be monitored. Moreover, Committee members emphasized that they would continue to consider periodically issues related to their long-run strategy for monetary policy, even if they were no longer setting ranges for the money and debt aggregates.

In the Committee's discussion of policy for the intermeeting period ahead, all the members supported a proposal to maintain an unchanged policy stance consistent with a federal funds rate averaging about 6½ percent. The increasing though still tentative indications of some slowing in aggregate demand, together with the likelihood that the earlier policy tightening actions had not yet exerted their full retarding effects on spending, were key factors in this decision. The uncertainties surrounding the outlook for the economy, notably the extent and duration of the recent moderation in spending and the effects of the appreciable tightening over the past year, including the ½ percentage point increase in the intended federal funds rate at the May meeting, reinforced the argument for leaving the stance of policy unchanged at this meeting and weighing incoming data carefully. Sev-

eral members commented that a considerable amount of new information bearing on the prospective strength of the economy and the outlook for inflation would become available during the relatively long interval before the next meeting in August. Members generally saw little risk in deferring any further policy tightening move, particularly since the possibility that underlying inflation would worsen appreciably seemed remote under prevailing circumstances. Among other factors, inflation expectations had been remarkably stable despite rising energy prices, and real interest rates were already relatively elevated.

In their discussion of the balance-of-risks sentence in the press statement to be issued shortly after this meeting, all the members agreed that the latter should continue to express, as it had for every meeting earlier this year, their belief that the risks remained weighted toward rising inflation. Indications that growth in aggregate demand was moderating to a pace closer to that of potential supply were still partial and tentative, and labor markets remained unusually tight. Many Committee members noted that, based on the currently available information, additional firming of policy could well be needed at some point in the future, though a number also expressed the opinion that less tightening probably would be required than they had thought at the time of the May meeting. Several emphasized that the press release should not convey the impression that the Committee now viewed further policy tightening moves as an unlikely prospect.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the Sys-

tem Account in accordance with the following domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 6½ percent.

The vote also encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks are weighted mainly toward conditions that may generate heightened inflation pressures in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Broaddus, Ferguson, Gramlich, Guynn, Jordan, Kelley, Meyer, and Parry. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 22, 2000.

The meeting adjourned at 10:35 a.m.

### Notation Vote

By notation vote completed on July 18, 2000, the Committee authorized Vice Chairman McDonough to accept the Legion of Honor to be awarded by the French government pursuant to a decision by the President of the French Republic.

Votes for this action: Messrs. Greenspan, Broaddus, Ferguson, Gramlich, Guynn, Jordan, Kelley, Meyer, and Parry. Votes against this action: None. Abstention: Mr. McDonough.

In conformance with regulations of the Board of Governors of the Federal Reserve System pertaining to foreign decorations, the Board's Vice Chairman, Mr. Ferguson, authorized Chairman Greenspan to accept the same award from the French government.

Donald L. Kohn  
Secretary

### **Meeting Held on August 22, 2000**

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, August 22, 2000, at 9:00 a.m.

#### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broadus  
Mr. Ferguson  
Mr. Gramlich  
Mr. Guynn  
Mr. Jordan  
Mr. Kelley  
Mr. Meyer  
Mr. Parry

Mr. Hoenig, Ms. Minehan,  
Messrs. Moskow and Poole,  
Alternate Members of the Federal  
Open Market Committee

Messrs. McTeer, Santomero, and Stern,  
Presidents of the Federal Reserve  
Banks of Dallas, Philadelphia, and  
Minneapolis respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Ms. Fox, Assistant Secretary  
Mr. Mattingly, General Counsel  
Ms. Johnson, Economist  
Mr. Stockton, Economist

Mr. Beebe, Ms. Cumming,  
Messrs. Goodfriend, Howard,  
Lindsey, Reinhart, Simpson, and  
Sniderman, Associate Economists

Mr. Fisher, Manager, System Open  
Market Account

Messrs. Madigan and Slifman,  
Associate Directors, Divisions  
of Monetary Affairs and Research  
and Statistics respectively, Board  
of Governors

Mr. Whitesell, Assistant Director,  
Division of Monetary Affairs,  
Board of Governors

Mr. Reifschneider, Section Chief,  
Division of Research and  
Statistics, Board of Governors

Ms. Low, Open Market Secretariat  
Assistant, Division of Monetary  
Affairs, Board of Governors

Mr. Kumasaka, Assistant Economist,  
Division of Monetary Affairs,  
Board of Governors

Mr. Connolly, First Vice President,  
Federal Reserve Bank of Boston

Ms. Browne, Mr. Hakkio, Ms. Krieger,  
Messrs. Lang, Rasche, Rolnick,  
and Rosenblum, Senior Vice  
Presidents, Federal Reserve  
Banks of Boston, Kansas City,  
New York, Philadelphia, St. Louis,  
Minneapolis, and Dallas  
respectively

Mr. Sullivan, Vice President, Federal  
Reserve Bank of Chicago

Mr. Tallman, Assistant Vice President,  
Federal Reserve Bank of Atlanta

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 27–28, 2000, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market transactions in foreign currencies for the System's account in the period since the

previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period June 28, 2000, through August 21, 2000. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that economic activity was expanding at a more moderate pace than earlier in the year. Growth in consumer spending had slowed from the outsized gains seen earlier, and sales of new homes and motor vehicles were down appreciably from their earlier highs. However, business spending on equipment and software had continued to surge, and industrial production was still trending upward. Even though expansion in employment had slowed considerably in recent months, labor markets remained extremely tight by historical standards, and some measures of labor compensation had accelerated. With productivity also continuing to accelerate, unit labor costs had changed little and measures of core price inflation had increased only mildly.

Total nonfarm payroll employment dropped appreciably in July after a small increase in June. Much of the weakness over the two months reflected substantial declines in the number of temporary Census workers. In the private sector, payroll gains had diminished somewhat on balance since the first quarter. The slowdown was particularly large in the usually robust services sector. Manufacturing employment, by contrast, had risen on net since the early spring after a lengthy decline. The civilian unemploy-

ment rate remained at 4.0 percent in July.

Industrial production registered further gains in June and July. Persisting strength in manufacturing output was accompanied by brisk increases in mining activity and sizable declines in utilities services associated with cooler-than-normal temperatures. In manufacturing, production of high-tech equipment and most other types of business equipment remained robust, but the manufacture of motor vehicles and parts dropped substantially in July after a small June decline. The further step-up in overall manufacturing activity lifted capacity utilization to a rate around its long-term average.

Growth of nominal retail sales picked up appreciably in July after having slowed noticeably in the second quarter. Sales rose sharply at general merchandisers, furniture and appliance stores, and outlets for other durable goods. However, outlays at automotive dealers declined substantially. Growth in household expenditures for services eased somewhat in the second quarter (latest available data), with a drop in spending for brokerage services more than accounting for the slowdown. The recent deceleration in consumer spending occurred against the background of moderate growth of real disposable income in recent quarters and little net change in stock market valuations thus far this year. Nevertheless, consumer sentiment continued to be very buoyant.

With mortgage rates at levels well above their average for last year, total private housing starts fell further in June and July, reaching their lowest level since late 1997. Sales of new single-family homes also were weaker in June (latest data). By contrast, sales of existing homes picked up somewhat in June. Consumers' assessments of homebuying

conditions and builders' ratings of new home sales remained soft.

Growth of business fixed investment, while still robust, slowed considerably in the second quarter after having surged in the first quarter. Business spending on equipment and software continued to expand at its very rapid first-quarter pace; investment in high-tech equipment (notably computers and communications equipment), software, and industrial machinery was particularly strong. By contrast, outlays for nonresidential structures weakened in the second quarter after a first-quarter burst.

The book value of manufacturing and trade inventories jumped in the second quarter. Part of the pickup reflected large increases in stocks of motor vehicles at wholesalers and automotive dealerships that left inventory-sales ratios in the motor vehicle sector at relatively high levels. Elsewhere, stockbuilding was only a bit stronger than sales, and inventory-sales ratios generally remained within their relatively low ranges for the preceding twelve months.

The U.S. trade deficit in goods and services changed little in June from its May level, but the deficit for the second quarter as a whole was appreciably larger than its average for the first quarter. Both exports and imports grew rapidly last quarter, though the dollar value of imports increased significantly more than the value of exports. The available information indicated that economic expansion was vigorous in both foreign industrial countries and major developing countries in the second quarter, but recent information pointed to some slowing of growth in these countries.

Recent data suggested that price inflation had picked up slightly. Consumer prices, as measured in the CPI, jumped in June in response to a surge in energy prices but climbed only modestly further in July, when energy prices changed

little. Excluding the food and energy components, consumer prices rose moderately in both months. For the twelve months ended in July, core CPI prices increased somewhat more than in the previous twelve-month period. When measured by the PCE chain-price index, however, the acceleration in core consumer prices during the last four quarters was very small. Producer prices exhibited a pattern that was generally similar to that of consumer prices. Prices of all finished goods jumped in June and were unchanged in July, and core producer prices were unchanged on balance in the June-July period. For the twelve months ended in July, core producer prices rose slightly more than in the previous twelve-month period. With regard to labor compensation, recent data suggested an acceleration, on balance, over the past year. Growth in hourly compensation for private industry workers slowed somewhat in the second quarter after having risen sharply in the first quarter. Over the four quarters ended in June, however, the change in compensation rates was substantially larger than the change over the previous four-quarter period. By contrast, the advance of average hourly earnings of production or nonsupervisory workers for the twelve months ended in July was about the same as that for the previous twelve-month period.

At its meeting on June 27-28, 2000, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with an unchanged federal funds rate of about 6½ percent. In reaching this decision, the members cited increasing though still tentative indications of some slowing in aggregate demand from an unsustainably elevated pace and the likelihood that the policy tightening actions implemented earlier had not yet exerted their full retarding effects on spending.

The members agreed, however, that the statement accompanying the announcement of their decision should continue to underscore their view that the risks remained weighted mainly in the direction of rising inflation.

Open market operations were directed throughout the intermeeting period toward maintaining the federal funds rate at the Committee's target level of 6½ percent, and the rate averaged close to the intended level. Other interest rates generally moved lower over the period, extending declines that had begun during the spring. Factors contributing to the most recent reductions included economic data releases that were viewed, on balance, as confirming earlier indications that demand growth was slowing to a more sustainable pace and that price pressures would remain damped, thereby lessening or potentially obviating further tightening of monetary policy. Most broad indexes of stock market prices rose somewhat over the period since the June meeting.

In foreign exchange markets, the trade-weighted value of the dollar increased on net against an index of major currencies, even though interest rate differentials moved against assets denominated in dollars relative to those of other industrial countries. At least in part, the dollar's appreciation reflected heightened market perceptions that economic growth in the United States, though evidently moderating from its rapid pace in recent quarters, was likely to continue to exceed that in most other industrial nations. The foreign exchange value of the dollar dropped slightly against the currencies of other important trading partners, paced by a substantial rise in the value of the Mexican peso in response to brightening political and economic prospects in Mexico.

The growth of domestic nonfinancial debt moderated slightly in the second

quarter as a result of an accelerated pay-down in federal debt, while private borrowing remained brisk. However, partial data for the period since midyear suggested that the overall growth in household and business borrowing might also be slowing somewhat. The expansion of M2 had declined substantially since late spring, apparently in part as a result of the widening opportunity costs of holding assets in M2 stemming from higher market interest rates and possibly also from slackening growth in household incomes. Sluggish currency flows were another contributing factor. At the same time, M3 accelerated in July and partial data pointed to further robust growth in August. The advance in this broader aggregate seemed to be driven by interest-sensitive inflows to M3's institutional money fund component.

The staff forecast prepared for this meeting suggested that the economic expansion, after slowing appreciably from its elevated pace of recent quarters, would be sustained at a rate a little below that of the staff's upwardly revised estimate of the economy's potential output. The forecast anticipated that the expansion of domestic final demand would be held back to some extent by the waning and eventual disappearance of positive wealth effects associated with outsized earlier gains in equity prices and by higher interest rates. As a result, growth of spending on consumer durables was expected to stay well below that in recent quarters and housing demand to stabilize at a level below recent highs. By contrast, the expansion of business fixed investment, notably in equipment and software, was projected to remain robust, and further solid economic growth abroad was expected to boost the expansion of U.S. exports for some period ahead. Core consumer price inflation was projected to rise somewhat over the forecast



horizon, in part as a result of higher import prices but largely as a consequence of some further increases in nominal labor compensation gains that would not be fully offset by growth in productivity.

In the Committee's discussion of current and prospective economic conditions, the members agreed that the information available since midyear provided increased evidence that the growth of aggregate demand and that of aggregate supply were coming into closer balance. The statistical evidence reviewed by the Committee, which was supported by widespread anecdotal reports, pointed to a noticeable slowing in the expansion of demand and economic activity. The slowdown was led by a moderation in consumer spending and some decline in housing expenditures that were occurring even before the full effects of earlier tightening in financial conditions had been felt. At the same time, an apparent continued acceleration in underlying productivity was boosting the economy's potential output growth and, in the context of the leveling out of the broadest measures of equity prices this year, was doing so without the full feedback on demand of previous such accelerations. While prices were rising somewhat more than a year ago, most of this pickup seemed to reflect the direct and indirect effects of higher energy prices, and the increase in productivity growth had kept unit labor costs well contained despite more rapid gains in compensation. These developments had much improved the prospects for a sustainable economic expansion at the prevailing stance of monetary policy. Even so, the members anticipated that labor markets would remain exceptionally tight, and with labor compensation already accelerating and higher energy prices potentially raising inflation expectations, they

agreed that the risks remained weighted toward rising inflation.

In the Committee's discussion of the outlook for the economy, members focused considerable attention on the growth rate of the economy's supply potential—its ability to satisfy further growth in demand on a sustainable basis. The widespread application of technological advances and the associated surge in outlays for capital equipment had been fostering an acceleration in labor productivity that seemed to be ongoing. Data on productivity and capital accumulation that had become available in recent months had tended to confirm these trends, and the statistical evidence was reinforced by comments from many business executives and by persistent upward revisions to long-term profit forecasts, which had yet to suggest a leveling out of productivity growth.

Quickening productivity had been the fundamental factor behind the economy's remarkable performance in recent years. Members noted, however, that historical episodes involving major changes in productivity trends had been rare, and the past therefore provided a limited basis for evaluating the course of future productivity developments. Accordingly, considerable caution needed to be exercised in assessing the outlook for productivity and in relying on projections of the economy and prices, which necessarily embodied judgments about this outlook, in making monetary policy. Another source of uncertainty related to the interactions of rising productivity and aggregate demand. Over the course of recent years, accelerating productivity gains had tended to boost aggregate demand by even more than potential aggregate supply owing to the effects of stronger profits on investment spending and, through the rising stock market, on consumption

as well. However, the leveling out in stock prices this year suggested that recent increases in productivity growth had been built into market expectations and prices some time ago and were not likely to provide the same impetus to demand going forward as had past productivity acceleration. Members cautioned nonetheless that the possibility that long-term interest rates and equity prices did not yet adequately reflect ongoing productivity gains could not be ruled out, with attendant effects boosting demand. Finally, rising productivity clearly had been a major force in containing inflation in a period of unusually low unemployment rates, and while some of the interactions between productivity growth and wages and prices could be adduced, these interactions involved complex processes that were very difficult to assess given the paucity of prior experience. As a consequence, judgments about labor market pressures, productivity, and inflation had to be viewed with care on the basis of evolving developments.

In their review of the outlook for expenditures in key sectors of the economy, members observed that growth in consumer spending had moderated substantially after a period of exceptional gains in late 1999 and early 2000. The clearest evidence of softening consumer demand tended to be concentrated in sales of motor vehicles and in housing-related durable goods. Available data on reduced growth in consumer spending were supported by anecdotal reports of some slippage in retail sales below expectations in several parts of the country. Factors underlying these developments included diminishing wealth effects after several months of limited changes in equity prices, the cumulative buildup in the stock of motor vehicles and other consumer durables owned by the public, and the constraining effects

of higher energy prices on incomes available to be spent on other goods and services. While these factors might well continue to damp the growth of consumer spending going forward, members noted that consumer confidence remained at a high level, consumer incomes were rising, and no anecdotal or other evidence pointed to any marked deterioration in consumer spending that would pose a potential threat to the sustainability of the economic expansion.

The housing sector provided the clearest indication of a response of aggregate demand to firming interest rates, affecting industries producing construction materials and household furnishings. Anecdotal reports from much of the country tended to confirm the statistical evidence of a downward trend in housing starts and home sales. Factors helping to explain the softness in housing, which included the rise that had occurred in mortgage interest rates and reported overbuilding in some metropolitan areas, were expected to continue to exert some downward pressure on housing activity. However, reference also was made to indications that wealth effects were continuing to boost housing demand and prices in parts of the country.

In sharp contrast to developments in the consumer and housing sectors, business outlays for capital equipment and software had continued to rise at exceptional rates, even after several years of rapid growth. The persistence of dramatic expansion evidently reflected expectations that such capital investments would continue to earn very high rates of return. Although the extraordinary rates of increase in investment outlays currently displayed little or no sign of abating, historical patterns indicated that even dramatic surges or shifts in technology invariably lost momen-

tum once the new technology was widely adopted, and rates of return on further investments tended to diminish. There was no reliable way to anticipate the timing of such a downturn and indeed little reason to expect a turnaround over the nearer term in the current investment boom. Members noted, however, that the investment outlook for the nonresidential construction sector presented a much more mixed picture. While such business investment continued to exhibit considerable vigor in many areas, it clearly had weakened in others and for the nation as a whole seemed poised for a relatively subdued advance in coming quarters. One factor pointing in the latter direction was evidence of more cautious attitudes on the part of many business executives and especially their lending institutions.

The strengthening economies of many U.S. trading partners were fostering rising demand for U.S. exports, a trend that seemed likely to persist according to reports from many domestic business contacts. Nonetheless, the nation's current account deficit apparently continued to increase, a development about which members expressed concern in view of the risks that it posed for the foreign exchange value of the dollar and domestic inflation over time. Still, the experience of the past few years clearly demonstrated that the dollar was likely to remain strong as long as foreign investors continued to see attractive investment opportunities in the United States. Past experience also suggested that international capital flows can quickly reverse themselves, but the timing of a major turnaround in the dollar, if any, could not be predicted with any degree of confidence.

In the Committee's discussion of the outlook for inflation, members noted that overall measures of price inflation had picked up to fairly high levels by

the standards of recent years, largely as a result of higher energy costs. Moreover, supply factors in major energy markets—petroleum, gas, and electricity generating capacity—did not point to significant relief for some considerable period of time. Still, core consumer price indexes remained relatively damped and had risen only a little over the past year, especially when measured by the PCE chain price index, and that suggested underlying price pressures remained largely contained. Nonetheless, a number of members were concerned that unusually taut labor markets could begin at some point to show through to increases in labor compensation in excess of productivity gains, pressuring unit costs and prices. Evidence of this had yet to emerge, perhaps because productivity continued to accelerate, but a flattening out of the rate of increase in productivity, even at a high level, could well pose at some point a risk to continued favorable inflation performance. To be sure, there were a number of positive factors in the outlook for inflation, including highly competitive conditions in many markets, stable and relatively favorable expectations with regard to the longer-run inflation outlook, and signs that the remarkable acceleration in productivity was continuing. On balance, however, the members saw a mild upward trend in key measures of inflation as a distinct possibility, albeit one that was subject to considerable uncertainty.

In the Committee's discussion of policy for the intermeeting period ahead, all the members endorsed a proposal to retain the current stance of policy, consistent with a federal funds rate continuing to average about 6½ percent. In their assessment of factors leading to this decision, the members focused on the further evidence that moderating demand and accelerating productivity

were closing the gap between the growth of aggregate demand and potential supply, even before earlier Committee tightening actions had exerted their full restraining effects. While the recent rally in domestic financial markets could be viewed as having partially eroded the degree of monetary restraint implemented earlier, real interest rates for private borrowers were still at relatively elevated levels, banking institutions were continuing to report further tightening of their standards and terms for business loans, equity prices had risen only modestly, and the dollar had firmed over recent months. In addition, the last few readings on core inflation had not suggested a further upward drift, unit labor costs were not increasing, and longer-term inflation expectations had been stable for some time. Accordingly, the Committee incurred little risk in leaving the stance of policy unchanged at this meeting and waiting to see how the various factors affecting both supply and demand in the economy unfolded and influenced the prospects for economic activity and prices.

At the same time, many members emphasized that the Committee needed to be prepared to act promptly should inflationary pressures appear to be intensifying, and in the Committee's discussion of the balance-of-risks sentence to be included in the press statement that would be issued after this meeting, all the members agreed that the sentence should continue to indicate that the risks to the economy remained weighted toward higher inflation in the foreseeable future. While the members did not expect underlying inflation to intensify materially, especially over the nearer term, the statement was intended to express their views about the longer term, and over that horizon they agreed that the risks lay in the direction of price acceleration. The risks of higher infla-

tion over time were seen importantly to stem from the unusually taut conditions in labor markets, which could place upward pressures on unit costs and prices, especially once productivity growth leveled out in the future. But members also cited the potential for persistently higher energy prices to affect longer-run inflation expectations, and the possibility that, taking into consideration recent declines in long-term interest rates, financial conditions might not yet be tight enough to balance aggregate demand and potential supply in the face of optimism about the growth of labor and capital income in association with accelerating productivity.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 6½ percent.

The vote also encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks are weighted mainly toward conditions that may generate heightened inflation pressures in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Broadus, Ferguson,

Gramlich, Guynn, Jordan, Kelley, Meyer, and Parry. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, October 3, 2000.

The meeting adjourned at 12:50 p.m.

Donald L. Kohn  
Secretary

### Meeting Held on October 3, 2000

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, October 3, 2000, at 9:00 a.m.

#### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broadus  
Mr. Ferguson  
Mr. Gramlich  
Mr. Guynn  
Mr. Jordan  
Mr. Kelley  
Mr. Meyer  
Mr. Parry

Mr. Hoenig, Ms. Minehan,  
Messrs. Moskow and Poole,  
Alternate Members of the Federal  
Open Market Committee

Messrs. McTeer, Stern, and Santomero,  
Presidents of the Federal Reserve  
Banks of Dallas, Minneapolis, and  
Philadelphia respectively

Mr. Kohn, Secretary and Economist  
Mr. Gillum, Assistant Secretary  
Ms. Fox, Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Baxter, Deputy General Counsel  
Ms. Johnson, Economist  
Mr. Stockton, Economist

Mr. Beebe, Ms. Cumming,  
Messrs. Eisenbeis, Howard,  
Lindsey, Reinhart, Simpson, and  
Sniderman, Associate Economists

Mr. Fisher, Manager, System Open  
Market Account

Messrs. Madigan and Slifman,  
Associate Directors, Divisions of  
Monetary Affairs and Research  
and Statistics respectively,  
Board of Governors

Mr. Winn, Assistant to the Board,  
Office of Board Members,  
Board of Governors

Mr. Ettin, Deputy Director, Division  
of Research and Statistics,  
Board of Governors

Messrs. Oliner and Struckmeyer,  
Associate Directors, Division  
of Research and Statistics,  
Board of Governors

Mr. Porter, Deputy Associate Director,  
Division of Monetary Affairs,  
Board of Governors

Mr. Whitesell, Assistant Director,  
Division of Monetary Affairs,  
Board of Governors

Mr. Ramm, Section Chief, Division  
of Research and Statistics,  
Board of Governors

Messrs. Reeve and Sack, Economists,  
Divisions of International Finance  
and Monetary Affairs respectively,  
Board of Governors

Ms. Low, Open Market Secretariat  
Assistant, Division of Monetary  
Affairs, Board of Governors

Mr. Kumasaka, Assistant Economist,  
Division of Monetary Affairs,  
Board of Governors

Messrs. Hakkio, Kos, Lacker,  
Ms. Mester, Messrs. Rasche,  
Rolnick, and Rosenblum,  
Senior Vice Presidents, Federal  
Reserve Banks of Kansas City,  
New York, Richmond,  
Philadelphia, St. Louis,  
Minneapolis, and Dallas  
respectively

Messrs. Evans and Rosengren,  
Vice Presidents, Federal Reserve  
Banks of Chicago and Boston  
respectively

Mr. Tallman, Senior Economist,  
Federal Reserve Bank of Atlanta

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 22, 2000, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets and on System transactions in those markets during the period August 22, 2000, through October 2, 2000. By unanimous vote, the Committee ratified these transactions.

In ratifying these transactions, members emphasized that the action was not intended to signal an increased willingness by the Committee to intervene in foreign exchange markets. In the current instance, the intervention transactions were undertaken in a spirit of cooperation with the international financial community and at the express request of the European Central Bank (ECB). Members commented that historical experience suggested that foreign exchange market interventions generally had not had lasting effects when not accompanied by supporting changes in macroeconomic policies.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal

agency obligations during the period August 22, 2000, through October 2, 2000. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that economic activity was expanding at a more moderate pace than in the first half of the year. The moderation reflected lower growth in most major expenditure sectors. As a result of the deceleration in aggregate demand, expansion of employment and industrial production had slowed. Rising energy prices had boosted overall price inflation considerably, but core measures of consumer inflation had increased substantially less.

Total nonfarm payroll employment dropped further in August, in part reflecting additional large declines in the number of temporary Census workers. In the private sector, a labor strike held down the August rise in payroll employment, but even after adjusting for the effects of the strike, the pace of private job gains in the July–August period fell considerably from the rate for the first half of the year. The slowdown was particularly pronounced in the construction, manufacturing, and services sectors. The civilian unemployment rate edged up to 4.1 percent in August.

Total industrial production rose only slightly on balance during July and August after having registered strong gains earlier in the year. The growth in production of high-tech equipment remained rapid, though not at the extraordinary rates posted earlier in the year, and softer conditions had emerged in a number of manufacturing industries, including steel, trucks, motor vehicles, and construction supplies. Because of the weakness in production, the rate

of capacity utilization in manufacturing edged down to a level slightly below its long-term average.

Consumer spending picked up somewhat in July and August from a moderate rate of increase in the second quarter. Real personal consumption expenditures on durable goods surged in the July–August period, spending on nondurable goods picked up somewhat less, and consumption of services decelerated a little. The recent strengthening of consumer spending occurred against the background of moderate growth of real disposable income in recent quarters but generally buoyant consumer sentiment.

With interest rates on fixed-rate mortgages having fallen significantly since mid-May and consumers' assessments of homebuying conditions having risen recently, single-family housing starts picked up somewhat in August. However, such starts were still sharply below their levels of early in the year, likely reflecting in part the recent smaller gains in income and employment and the flattening out of equity prices thus far this year. New home sales picked up in July (latest data), though that gain might have been overstated as a result of problems with estimation procedures, and existing home sales bounced back in August, roughly offsetting a drop in July. Multifamily starts, by contrast, declined further in August even though vacancy rates remained low and apartment rents continued to rise.

The available information suggested that business investment in durable equipment and software increased substantially further in the third quarter. Data on shipments of nondefense capital goods in July and August indicated that outlays for high-tech equipment, notably computing and communications equipment, remained quite strong. For other types of equipment, spending growth seemed to have moderated

somewhat after the substantial gains of the first half of the year. Information on orders for nondefense capital goods pointed to further slowing in the pace of spending increases in coming months. Nonresidential construction activity fell in July but market fundamentals, including rising property values and lower vacancy rates, suggested the likelihood of further expansion in nonresidential investment, particularly in office buildings.

Business inventory investment decreased sharply in July after a large second-quarter advance. Much of the slowdown was associated with a runoff of stocks of motor vehicles at wholesalers and automotive dealerships. Elsewhere, stockbuilding eased a little and sales decelerated somewhat. Inventory–sales ratios generally were within their ranges for the preceding twelve months, and there seemed to be only a few scattered indications of inventory imbalances at the industry level.

The U.S. trade deficit in goods and services widened considerably in July from its June level, with the dollar value of exports retracing part of its extraordinary June increase and the value of imports rising further. The drop in exports was concentrated in aircraft and automotive products, while the advance in imports was largely in industrial supplies, automotive products, and services. The available information indicated that economic expansion in the foreign industrial countries had slowed somewhat in the third quarter from the robust growth during the first half of the year, primarily reflecting reduced economic expansion in Japan. Growth appeared to be somewhat uneven among the developing countries in the third quarter but remained solid on balance.

Recent information continued to indicate a slight pickup in price inflation.

Consumer prices edged up on balance over July and August, despite a net drop in energy prices; excluding the food and energy components, consumer price inflation remained moderate in both months. On a year-over-year basis, however, core consumer prices increased somewhat more in the twelve months ended in August than in the previous twelve-month period. Core producer prices edged up over the July–August period and decelerated a little on a year-over-year basis. With regard to labor costs, average hourly earnings of production or nonsupervisory workers rose moderately in July and August. The advance for the twelve months ended in August was slightly larger than that for the previous twelve-month period.

At its meeting on August 22, 2000, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with an unchanged federal funds rate of about 6½ percent. In reaching their decision, the members noted that decelerating demand and surging productivity seemed to have narrowed the gap between the growth rates of aggregate demand and potential supply, even though previous policy tightening actions had not yet exerted their full restraining effects. The members emphasized, however, that unusually taut labor markets could result in greater upward pressures on unit costs and prices, especially if productivity growth were to level out or edge lower in the future, and they agreed that the statement accompanying the announcement of their decision should continue to indicate that the risks remained weighted mainly in the direction of rising inflation.

Open market operations throughout the intermeeting period were directed toward maintaining the federal funds rate at the Committee's targeted level of 6½ percent, and the average rate was

close to the intended level. Most short- and intermediate-term interest rates moved lower over the interval, though long-term yields changed little or drifted slightly higher. Market expectations about the near-term prospects for interest rates were revised downward in response to both the Committee's statement after the August meeting, which was interpreted as expressing greater confidence that growth rates of aggregate demand and aggregate supply were coming into better alignment, and to subsequent data releases, which were seen as confirming earlier indications of some slowing in the economic expansion. Against a background of some upward pressure on long-term Treasury yields and of growing concerns about corporate earnings, most broad indexes of stock market prices declined somewhat over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar increased somewhat further on balance in terms of an index of major foreign currencies. The dollar's net appreciation against the euro occurred despite a small policy tightening by the ECB on August 31 as sentiment toward that currency remained negative, in part because of concerns about capital flows out of the euro area. The major industrial countries undertook joint foreign exchange intervention late in the period, on September 22, to stem the euro's slide. The intervention was at the initiative of the ECB and was joined by the United States and other nations because of shared concern about the potential implications of recent movements in the euro. The dollar also posted gains against the currencies of a number of other important trading partners, notably the Brazilian *real* and the Mexican peso.

The broad monetary aggregates had expanded relatively briskly in recent



months. The growth of M2, perhaps reflecting the recent vigor of consumer spending, picked up considerably in August and September after having increased slowly in June and July. Averaged across the past four months, however, M2 increased at a pace noticeably below that of earlier in the year, with the slowdown partly reflecting a lagged response to a widening, during the first half of the year, of the opportunity costs of holding M2 assets. M3 expansion remained robust in August and September, though somewhat below the pace in the first half of the year. The growth of domestic nonfinancial debt slowed somewhat in July and August in association with some moderation in the brisk pace of private borrowing that was offset in part by a less rapid paydown of federal debt.

The staff forecast prepared for this meeting suggested that the economic expansion, after slowing considerably from its elevated pace of recent quarters, would be sustained at a rate a little below the staff's current estimate of the economy's potential output. The forecast anticipated that the expansion of domestic final demand would be held back to some extent by the eventual disappearance of positive wealth effects associated with outsized earlier gains in equity prices and by higher interest rates. As a result, growth of spending on consumer durables was expected to remain appreciably below that in recent quarters, and housing demand would trend slightly downward. By contrast, business fixed investment, notably outlays for equipment and software, was projected to remain robust, and brisk growth abroad would boost the expansion of U.S. exports for some period ahead. Core consumer price inflation was projected to rise a little over the forecast horizon, in part as a result of higher import prices but largely as a

consequence of further increases in nominal labor compensation gains that would not be fully offset by growth in productivity.

In the Committee's discussion of current and prospective economic developments, members referred to recent statistical and anecdotal information that tended to confirm earlier indications of appreciable slowing in the pace of the expansion from the outsized increases experienced in the latter part of 1999 and the first half of this year. Several commented that growth of aggregate demand now appeared to be closer to, and perhaps slightly below, the rate of expansion in the nation's output potential. Looking ahead, they generally anticipated that the softening in equity prices and the rise in interest rates that had occurred earlier in the year would contribute to keeping growth in demand at a more subdued but still relatively robust pace. The members recognized that marked uncertainties surrounded any forecast in present circumstances. Those uncertainties had been augmented by recent developments in world oil markets and continued to include questions about the extent of further gains in productivity, the effects of such gains on the growth of aggregate demand as well as supply, and the associated degree of prospective pressures on resources and inflation. In the latter regard, members anticipated that even assuming reduced economic growth in line with their forecasts and further impressive gains in productivity, conditions in labor markets were likely to remain relatively tight, and risks persisted that at some point such tightness could exert upward pressures on labor costs and prices.

Developments in world oil markets also might exert continued upward pressure on inflation, while at the same time posing a downward risk to economic activity. Uncertainties relating to politi-

cal events in the Middle East, superimposed on limited available inventories of oil products held by producers and refiners, had fostered recent "spikes" in oil prices. While price quotations in futures markets pointed to a decline in oil prices over time, such prices might well remain relatively elevated for an extended period, with negative effects on spending and inflation. There already were scattered signs that higher energy prices, by reducing income available for discretionary purchases, might be damping retail sales. Moreover, to the extent that relatively high oil prices persisted, they were likely to have increasing pass-through effects on core measures of inflation as well as on "headline" inflation, especially if the energy price increases began to affect inflation expectations. However, the course of oil prices was very difficult to predict not only because of political and market uncertainties but in part also because of the lack of information about the extent of what appeared to be a precautionary buildup of fuel supplies by households and retail businesses.

In their review of the outlook for household spending, members cited a number of developments that pointed to slower but continuing growth. With some exceptions, anecdotal reports from various parts of the country suggested a recent softening in retail sales, and some industry contacts indicated that they were marking down their forecasts of retail sales. A flat and volatile stock market and the rise in energy costs appeared to be key factors currently tending to inhibit growth in consumer spending at least to some extent. On the positive side, continuing gains in consumer incomes and a high level of consumer confidence could be expected to foster sustained growth in such spending, albeit probably at a pace below recent trends.

With regard to the outlook for residential construction, anecdotal reports indicated some softening in housing activity in many parts of the country, though some members cited regional evidence of a partial rebound recently that was attributed to declines in mortgage interest rates. However, financial factors, including mortgage interest rates at levels still appreciably above earlier lows and the sideways performance of the stock market, were expected to constrain housing activity somewhat over coming quarters, though such activity likely would remain on a relatively high plateau.

In their comments about the prospects for business fixed investment, members cited some indications that the expansion in business spending for equipment and software might be moderating from the extraordinary pace of recent years, though growth in such expenditures probably would remain robust. Retarding influences bearing on the outlook for investment expenditures included forecasts of slower growth in final demand and less favorable financial conditions, notably weakness in the equity prices of numerous "new economy" firms and tightening credit availability for business firms that did not enjoy investment-grade credit ratings or favorable earnings prospects. Evidence of overbuilding in some areas of commercial and other nonresidential real estate also was mentioned. Against this background, some members referred to a growing sense of caution among business- and financial-sector executives about undertaking or financing business investments. At the same time, the incentive to take advantage of increasingly efficient high-tech equipment and software, typically available at declining prices, would continue to provide an important underpinning for further large gains in investment spending, with favorable impli-

cations for continued rapid growth in productivity.

In their assessment of the outlook for inflation, members agreed that although forecasts of more moderate growth in aggregate demand at a pace around potential output had substantially reduced the odds of rising inflation, the risks still were pointed in that direction on balance. Even so, any increase in inflation was likely to be modest and gradual and was subject to substantial uncertainty for a variety of reasons. As noted previously, the behavior of oil prices was one highly uncertain source of potentially greater inflation pressures. Another major source of uncertainty was the prospective performance of productivity. Largely as a consequence of rapidly expanding "new economy" investments, gains in productivity had occurred at remarkable rates in recent years. However, the anticipated moderation in the expansion of economic activity and the related softening in expected returns on such investments might well restrain the further expansion of investment spending and limit the associated pickup in productivity. Once productivity growth tended to level out, employers would find it more difficult to offset the rise in their costs that might occur should tight labor markets persist. Finally, a decline in the dollar from its current level, should that happen, might add to inflation pressures going forward. On the more positive side, there were no signs that the pace of productivity gains was currently leveling out and no evidence of rising longer-term inflation expectations. Moreover, cost pressures and price inflation had remained subdued for an extended period despite low rates of unemployment that in the past had been associated with increasing inflation.

Against the backdrop of these uncertainties and the current performance of

the economy, all the Committee members indicated that they favored an unchanged policy stance for the intermeeting period ahead. In support of this view, they placed considerable weight on widespread indications, reinforced by developments since the August meeting, that growth in aggregate demand had moderated appreciably to a pace that improved the prospects for containing pressures on resources. Moreover, the tightening that had occurred in financial conditions through the spring and the rise in energy prices since the fall of 1998 had not yet exerted their full effects on aggregate demand, and members expected these effects to contribute to a more sustainable rate of growth in aggregate spending. Although inflation had picked up, a decline in energy prices, should it materialize in line with market expectations, clearly would have favorable implications for inflation expectations and cost pressures in the economy. Questions nonetheless remained regarding the extent and duration of the slowdown in the economic expansion and the other factors bearing on the outlook for inflation, especially against the backdrop of substantial pressures on labor resources.

All the members agreed that their views regarding the outlook for inflation were consistent with retaining the press release sentence indicating that the risks remained weighted toward higher inflation over time. Some expressed the opinion that those risks were now less decidedly tilted to the upside and that a reconsideration of the sentence might be warranted over the next several months, but they believed that a change at this point would be premature. While the prospects of a significant rise in inflation seemed quite limited for the nearer term, the members agreed on the need to remain especially

vigilant for signs of potentially rising inflation over the intermediate term, particularly since any increase in inflation would occur from a level that in the view of many members was already on the high side of an acceptable range.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it is instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 6½ percent.

The vote also encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks are weighted mainly toward conditions that may generate heightened inflation pressures in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Broaddus, Ferguson, Gramlich, Gynn, Jordan, Kelley, Meyer, and Parry. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Wednesday, November 15, 2000.

The meeting adjourned at 12:05 p.m.

Donald L. Kohn  
Secretary

## **Meeting Held on November 15, 2000**

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Wednesday, November 15, 2000, at 9:00 a.m.

### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broaddus  
Mr. Ferguson  
Mr. Gramlich  
Mr. Gynn  
Mr. Kelley  
Mr. Meyer  
Mr. Parry

Mr. Hoenig, Ms. Minehan,  
Messrs. Moskow and Poole,  
Alternate Members of the Federal  
Open Market Committee

Messrs. McTeer, Stern, and Santomero,  
Presidents of the Federal Reserve  
Banks of Dallas, Minneapolis, and  
Philadelphia respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Mr. Gillum, Assistant Secretary  
Ms. Fox, Assistant Secretary  
Mr. Mattingly, General Counsel  
Ms. Johnson, Economist  
Mr. Stockton, Economist

Ms. Cumming, Messrs. Eisenbeis,  
Goodfriend, Howard,  
Lindsey, Reinhart, Simpson,  
and Sniderman, Associate  
Economists

Mr. Fisher, Manager, System Open  
Market Account

Mr. Winn, Assistant to the Board,  
Office of Board Members, Board  
of Governors

Mr. Ettin, Deputy Director, Division  
of Research and Statistics, Board  
of Governors

Mr. Madigan, Associate Director,  
Division of Monetary Affairs,  
Board of Governors

Messrs. Oliner, Slifman, and  
Struckmeyer, Associate  
Directors, Division of Research  
and Statistics, Board of Governors

Mr. Whitesell, Assistant Director,  
Division of Monetary Affairs,  
Board of Governors

Ms. Low, Open Market Secretariat  
Assistant, Division of Monetary  
Affairs, Board of Governors

Mr. Barron and Ms. Pianalto, First  
Vice Presidents, Federal Reserve  
Banks of Atlanta and Cleveland  
respectively

Messrs. Hakkio, Hunter, Ms. Mester,  
Messrs. Rasche, Rolnick, and  
Rosenblum, Senior Vice  
Presidents, Federal Reserve  
Banks of Kansas City, Chicago,  
Philadelphia, St. Louis,  
Minneapolis, and Dallas  
respectively

Messrs. Fuhrer, Judd, and  
Ms. Perelmuter, Vice Presidents,  
Federal Reserve Banks of Boston,  
San Francisco, and New York  
respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 3, 2000, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period

October 3, 2000, through November 14, 2000. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic situation and outlook and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that economic growth had slowed appreciably from the rapid pace in the first half of the year. The slowdown was most apparent in housing construction and business investment in equipment and software, while consumer spending remained on a relatively solid upward trend. With expansion of aggregate demand less robust, industrial production and employment were rising at appreciably slower rates, though unemployment remained very low. Core inflation appeared to be increasing, but very gradually and in part reflecting the indirect effects of higher energy costs.

Growth in private nonfarm payroll employment slowed in October from the moderate September rate; since mid-year, employment growth had been considerably lower than earlier in the year. The falloff in growth was concentrated in the manufacturing, retail trade, and temporary help services industries. By contrast, the pace of hiring was brisk in real estate and construction and slowed only slightly in services industries other than temporary help. The civilian unemployment rate held at its current cyclical low of 3.9 percent in October.

Industrial production edged down in October, after its growth had dropped abruptly in the third quarter to a pace well below that recorded during the first half of the year. Manufacturing output was unchanged in October; a further sharp decline in production of motor vehicles followed on the heels of a third-quarter slump, and the manufacture of

other durables also fell. Expansion of output of high-tech equipment, which had been extraordinarily rapid earlier in the year, slowed somewhat in October. With production unchanged in October, the rate of capacity utilization in manufacturing fell to a level slightly below its long-term average.

Nominal retail sales edged up in October after rising substantially in the third quarter. Nondurable goods stores, notably apparel, registered a sizable increase in October sales, but that gain was more than offset by declines in outlays for durable goods, particularly motor vehicles. Consumer spending for services continued to grow at a moderate rate through September (latest data). Recent consumer buying patterns seemed to reflect moderate growth of real disposable income in recent quarters and still generally buoyant consumer sentiment.

Single-family housing starts declined further in the third quarter as a whole. Nevertheless, the drop in interest rates on fixed-rate mortgages since mid-May might have sparked the slight increase, on balance, in single-family housing starts in August and September and the upturn in new home sales in the third quarter. After a strong first half, multifamily starts dropped in the third quarter despite low vacancy rates and rising apartment rents.

Business investment in durable equipment and software decelerated sharply in the third quarter. In the high-tech area, spending on computers and related equipment as well as software recorded further robust gains. However, expenditures on communications equipment declined after a half-year of very strong increases, and outlays for other types of equipment also softened; investment in aircraft, autos, trucks, and construction and mining equipment fell, while growth of spending on agricultural and

industrial equipment slowed. Despite the third-quarter weakness in expenditures, recent data on orders for nondefense capital goods suggested that spending for many types of equipment remained on an upward trend. Data on construction put in place indicated that nonresidential building activity picked up considerably in the third quarter, with the institutional, industrial, and office categories recording solid gains. Market fundamentals, including rising property values and low vacancy rates, suggested that further expansion of office building was likely. Other commercial construction, by contrast, remained weak, partly reflecting the already substantial stock of large retail stores and regional malls.

The pace of inventory investment slowed considerably in the third quarter. However, for a second consecutive quarter, the book value of inventories rose faster than sales, and inventory overhangs were evident in some industries. In manufacturing, stock accumulation edged up and the aggregate stockshipments ratio in September, though still quite low by historic norms, was just above the middle of its range over the preceding twelve months. In the wholesale sector, inventory accumulation dropped in the third quarter; however, sales declined and the aggregate inventory-sales ratio for the sector was at the top of its narrow range over the past year. Retail stockbuilding also slowed in the third quarter, with much of the drop reflecting reductions in motor vehicle inventories at auto dealers. The aggregate inventory-sales ratio for this sector edged lower and was near the middle of its range over the past year.

The U.S. trade deficit in goods and services narrowed in August after having widened considerably in July; on balance, the trade deficit increased somewhat from its second-quarter level.

The value of exports grew in the July–August period at about the same strong pace as that recorded for the second quarter. The value of imports also rose briskly over the two months, but at a slightly lower rate than that of the second quarter. The available information indicated that, on average, economic expansion in the foreign industrial countries slowed appreciably in the third quarter from the elevated pace during the first half of the year and that the slowdown importantly reflected little or no growth in Japan. In addition, economic activity appeared to have decelerated in many developing countries in the third quarter but remained solid in most of those nations.

Incoming data continued to indicate that price inflation had picked up somewhat. Consumer prices, as measured by the consumer price index (CPI), rose considerably in September (latest data) after having edged down in August; a sizable step-up in energy prices and a noticeable increase in core inflation contributed about equally to the acceleration. Although the core measure of CPI prices accelerated noticeably in the twelve months ended in September compared with the previous twelve-month period, personal consumption expenditure (PCE) price inflation had been about steady. By contrast, core producer prices dropped a little in October and decelerated somewhat on a year-over-year basis, though the deceleration was more than accounted for by a surge in tobacco prices during the year ended in October 1999. With regard to labor costs, the third-quarter rise in the employment cost index (ECI) for hourly compensation of private industry workers was smaller than the elevated increase of the previous quarter. However, ECI compensation advanced considerably more during the year ended in September than in the previous year,

with larger increases in benefits accounting for much of the rise. Average hourly earnings of production or nonsupervisory workers increased at a slightly higher rate in both October and the twelve months ended in October.

At its meeting on October 3, 2000, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with an unchanged federal funds rate of about 6½ percent. In taking that action, the members noted that the growth of aggregate demand had moderated appreciably, the prospects for a significant rise in inflation seemed quite limited for the near term, and previous policy tightening actions and the earlier rise in energy prices had not yet exerted their full restraining effects on demand. Nevertheless, in the context of continuing substantial pressures on labor resources and the potential effects of the previous rise in energy prices on inflation expectations, members believed it was necessary to remain on guard for signs of rising inflation over the intermediate term. As a result, they agreed that the statement accompanying the announcement of their decision should continue to indicate that the risks remained weighted mainly in the direction of rising inflation.

Open market operations were directed throughout the intermeeting period toward maintaining the federal funds rate at the Committee's targeted level of 6½ percent, and the average rate remained close to the intended level. Short- and intermediate-term market interest rates registered small mixed changes over the intermeeting interval. At longer maturities, Treasury coupon yields drifted slightly lower, and rates on high-grade corporate securities changed little. However, growing market concerns about the outlook for corporate earnings led to substantial

increases in interest rates on lower-rated investment-grade and high-yield bonds, and the early November survey of senior loan officers indicated that banks had tightened further their standards and terms for business loans. The mixed reports on corporate earnings, incoming information indicating slower growth in economic activity in the United States, and wide swings in and uncertainty about the price of oil contributed to a sharp drop in broad indexes of stock market prices over the period in volatile trading.

In foreign exchange markets, the trade-weighted value of the dollar increased slightly further on balance over the intermeeting interval in terms of the currencies of a broad group of U.S. trading partners. Among the major foreign currencies, the dollar moved up against the euro and the Canadian and Australian dollars but edged down a bit in terms of the yen. The dollar rose to a record level against the euro in the weeks following the FOMC meeting, but the release of weaker-than-expected U.S. economic growth data in late October was seen as possibly marking a shift in the relative growth rates, and the dollar subsequently gave up much of its intermeeting gains in terms of the euro. The dollar also posted gains against an index of the currencies of other important trading partners, largely reflecting conditions in some emerging economies. Concerns about Argentina's recent economic and fiscal performance and its external financing situation spilled over to other Latin American countries, notably Brazil and Mexico, and political developments in Indonesia and the Philippines depressed the currencies of those countries.

The broad monetary aggregates decelerated in October. The slower growth of M2 followed strong expansion in August and September, however, and

growth since midyear was at about the same pace as in the first half of the year. M3 also increased at a slower rate in October, partly reflecting weakness in bank lending and declines in bank holdings of securities. The growth of domestic nonfinancial debt picked up in September in association with an increase in the pace of private borrowing and a less rapid paydown of federal debt.

The staff forecast prepared for this meeting suggested that the economic expansion, having slowed considerably, would be sustained over the forecast horizon at a rate a little below the staff's current estimate of the economy's potential output. The forecast anticipated that the expansion of domestic final demand would be held back to some extent by the waning influence of the positive wealth effects associated with past outsized gains in equity prices but also by some firming of conditions in credit markets. As a result, growth of spending on consumer durables was expected to be appreciably below that in recent quarters and housing demand to trend slightly downward. By contrast, business fixed investment—notably, outlays for equipment and software—was projected to remain relatively robust, and brisk growth abroad would undergird the expansion of U.S. exports. Core price inflation was projected to rise a little over the forecast horizon, in part as a result of higher import prices but largely as a consequence of further increases in nominal labor compensation gains that would not be fully offset by growth in productivity.

In the Committee's discussion of current and prospective economic conditions, members commented that the information that had become available since the previous meeting had reinforced earlier indications of appreciable slowing in the expansion of



economic activity. The cumulating evidence of moderating expansion seemed especially clear in the information on employment growth and manufacturing output. Aggregate demand currently appeared to be growing at a pace a little below the rate of increase in the economy's output potential, a configuration that could well persist in coming quarters. Actual and expected shortfalls in business profitability had led to tighter credit conditions for many borrowers and lower equity prices, which would continue to restrain spending; moreover, further pressure on profit margins, with adverse effects on financial markets, business investment, and consumer spending, was a distinct possibility. Members observed, however, that economic growth had rebounded sharply from temporary slowdowns previously in the current expansion, and several noted the possibility that a less restrictive fiscal policy stance would be bolstering demand in the years ahead.

Although the softening in aggregate demand moved in the direction of containing potential inflation pressures, the members continued to be concerned about the possibility that inflation would edge higher. Even with demand growth slower, labor markets were likely to remain unusually tight for some time, and in such circumstances labor costs could begin to rise increasingly in excess of even elevated gains in productivity. Some members also commented that energy prices might not trend lower as soon as, or to the extent, now expected by market analysts, and a few raised the prospect that the dollar might depreciate from its currently elevated level and add to potential upward pressures on domestic prices over the forecast horizon.

A key factor underlying the economic outlook was the emergence in recent months of less accommodative financial

conditions for many businesses, including some further tightening since the meeting in early October, and decreases in the wealth of households. The slowdown in the pace of the expansion and disappointing business earnings had fostered more cautious attitudes on the part of lending institutions and investors. Anecdotal comments from around the country supported the indications from surveys of tightening terms and standards at banks for business borrowers. At the same time, spreads in securities markets had widened, most sharply on obligations of borrowers rated below investment grade, and as a result those borrowers faced higher credit costs. Lender caution and less receptive markets probably had contributed to considerable weakening recently in overall growth of credit to nonfinancial businesses. Rising interest and energy costs in conjunction with restraint on the prices of final output had depressed the earnings and stock market valuations of many firms, notably in the high-tech area, with adverse repercussions on their ability to borrow and willingness to invest and on the financial position of the households holding their equity shares.

Less hospitable conditions in financial markets for a number of borrowers and deteriorating profit margins had contributed to a substantial moderation in the growth of business fixed investment in recent months, and anecdotal reports of reductions in capital spending plans were consistent with continued more moderate expansion in such outlays. The recent deceleration was especially pronounced in expenditures for high-tech equipment and software, though such spending was still growing at a robust pace. It was suggested that the weakening expansion of expenditures in these capital goods might reflect a surfeit in capacity following a period

of extraordinary growth in many industries—for example, those related to fiber optics. The available evidence did not indicate any material decrease in the optimism of equity market analysts as a group regarding the outlook for earnings over the long term. This suggested that their contacts among business executives remained fundamentally upbeat about the long-term prospects for productivity and earnings. In these circumstances, appreciable further growth in investment spending seemed to be in prospect for coming quarters, though undoubtedly at a slower pace than had been experienced on average in recent quarters.

Even limited slowing in the expansion of investment expenditures could be expected to have retarding effects on the growth of consumer income and spending. While such spending had held up well in the third quarter, the limited information available on more recent developments suggested some softening, though the data were not conclusive. Factors cited in support of a somewhat weaker trajectory in consumer spending included the impact of elevated energy costs, the high debt burdens of many households, and the ebbing of the wealth effects from strong earlier gains in stock market prices. Even so, anticipated increases in employment and income and still relatively high levels of consumer confidence were likely to support appreciable further growth in consumer spending, albeit probably at a rate somewhat below the brisk pace of the past few years.

Key indicators of housing activity had fluctuated considerably this year, but the evidence of recent months pointed on balance to a mild softening in such activity, a perception that was supported by anecdotal reports from several areas around the country. In general, housing

demand was expected to edge lower in response to the same income and wealth effects that were influencing consumer durables expenditures and to the increase in mortgage interest rates that had occurred on net over the past year.

Current forecasts of appreciable growth in foreign economic activity had favorable implications for U.S. exports and the nation's trade balance, but some members expressed concern about financial and economic weakness in a number of foreign economies. Failure to remedy structural and other problems in some countries incurred the risk of economic and financial distress, with possible spillover effects on other economies and financial markets. While those risks seemed small, they might be difficult to contain. The exchange value of the dollar was another source of uncertainty for the outlook. In the view of some members, the dollar could well come under downward pressure as the nation's current account deficits continued to cumulate. A lower dollar would tend to have a favorable effect on the trade deficit but also would add to inflationary pressures in the domestic economy.

Members continued to be concerned about the outlook for inflation. Measured increases in "headline" consumer prices could be explained mostly as a result of sharp advances in energy prices, which many observers expected to be reversed at some point. However, core consumer price measures also displayed a gradual uptrend, perhaps only in part as a consequence of the pass-through effects of persistently high energy prices. Measures of labor compensation appeared to be accelerating, partly as a result of sharply rising health benefit costs. To be sure, unit labor costs in the nonfinancial corporate sector had changed little over the past year, undoubtedly reflecting impressive

further gains in productivity. Even so, higher interest rates and increased energy and other input costs were adding to overall production expenses. To date, competitive pressures were continuing to inhibit the ability of many firms to pass on those costs, although a significant exception was a number of successful efforts to impose energy surcharges.

Looking to the future, however, the members generally agreed that the risks were in the direction of a heightening in inflation pressures despite their belief that growth in overall demand now seemed to have declined to a more sustainable pace and probably would continue to expand for a time at a rate below that of the economy's output potential. The members believed that growth in labor compensation was likely to remain under upward pressure from the anticipated persistence of very tight conditions in labor markets that would enable wages to catch up to earlier gains in labor productivity. Whether offsetting increases in the growth of labor productivity would materialize was open to question, in part because productivity growth might tend to level out in the context of less ebullient expansion in business investment. Another key factor in the outlook for inflation was the course of oil and other energy prices. Thus far, increases in energy costs had been reflected only marginally in core consumer prices, and while there were widespread market expectations of declining oil prices in coming quarters, a great deal of uncertainty, including the potential for more difficulties in the Middle East, surrounded the timing and extent of such an outcome. The longer relatively high energy prices persisted, of course, the greater might be their imprint on both inflation expectations and core prices. In sum, the moderation in economic expansion, the persistence

of highly competitive conditions in most domestic markets, the outlook for continued robust gains in productivity, and relatively subdued inflation expectations were favorable factors in the inflation outlook, but the members continued to view the prospects as weighted on balance in the direction of a gradual uptrend in core inflation.

In the Committee's discussion of policy for the intermeeting period ahead, all the members supported a proposal to maintain an unchanged policy stance consistent with the federal funds rate continuing to average about 6½ percent. Despite clear indications of a more moderate expansion in economic activity, persisting risks of heightened inflation pressures remained a policy concern, particularly in the context of an evident, if gradual, uptrend in key measures of core inflation. Indeed, a few members commented that measures of core inflation already were near or slightly above levels that they viewed as acceptable for the longer run. Although overall financial conditions had tightened during the course of recent months and currently appeared to be holding down the growth in spending, this added restraint was likely to be necessary to contain inflation pressures. In these circumstances, all the members saw the maintenance of a steady policy as the best course at this juncture to promote the Committee's longer-run objectives of price stability and sustainable economic expansion.

Still, growth had slowed more quickly than many members had anticipated, and financial market and other developments now seemed more likely to keep pressures on resources from mounting over coming quarters. Under the circumstances, the members focused at this meeting on the potential desirability of moving from a statement of risks weighted toward rising inflation to one that indicated a balanced view of the

risks to the Committee's goals of price stability and sustainable economic growth. The members agreed that a stronger case could be made for a shift to a balanced risk statement than at the previous meeting. A few indicated that the decision was a close call for them, and several commented that developments might be moving in a direction that would make a shift advisable in the relatively near future. Even so, they were unanimous in concluding that such a change would be premature at this time. Concerns about the possibility of rising inflation persisted. And while the members could see an increased risk of a marked slowing of growth relative to the rapid rate of expansion of the economy's potential, the degree to which growth in demand might remain sufficiently damped to contain and offset those inflation pressures was quite uncertain. Moreover, a shift in the Committee's published views might induce an undesirable softening in overall financial market conditions, which in itself would tend to add to inflation pressures. The members concluded that retaining a risk statement weighted toward more inflation pressures would best represent their current thinking, but they believed it was desirable to provide some recognition of the emergence of increased downside risks to the economic expansion in the statement to be released after this meeting.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-

run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 6½ percent.

The vote also encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks are weighted mainly toward conditions that may generate heightened inflation pressures in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Broadus, Ferguson, Gramlich, Guynn, Kelley, Meyer, Moskow, and Parry. Votes against this action: None. Mr. Moskow voted as alternate member for Mr. Jordan.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 19, 2000.

The meeting adjourned at 1:00 p.m.

Donald L. Kohn  
Secretary

### **Meeting Held on December 19, 2000**

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, December 19, 2000, at 9:00 a.m.

#### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broadus  
Mr. Ferguson  
Mr. Gramlich  
Mr. Guynn  
Mr. Jordan

Mr. Kelley  
Mr. Meyer  
Mr. Parry

Mr. Hoenig, Ms. Minehan,  
Messrs. Moskow and Poole,  
Alternate Members of the Federal  
Open Market Committee

Messrs. McTeer, Santomero, and Stern,  
Presidents of the Federal Reserve  
Banks of Dallas, Philadelphia, and  
Minneapolis respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Ms. Fox, Assistant Secretary  
Mr. Gillum, Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Baxter, Deputy General Counsel  
Ms. Johnson, Economist  
Mr. Stockton, Economist

Mr. Beebe, Ms. Cumming,  
Messrs. Goodfriend, Howard,  
Lindsey, Reinhart, Simpson, and  
Sniderman, Associate Economists

Mr. Fisher, Manager, System Open  
Market Account

Mr. Winn, Assistant to the Board,  
Office of Board Members,  
Board of Governors

Mr. Ettin, Deputy Director, Division  
of Research and Statistics,  
Board of Governors

Mr. Madigan, Associate Director,  
Division of Monetary Affairs,  
Board of Governors

Messrs. Oliner, Slifman, and  
Struckmeyer, Associate Directors,  
Division of Research and  
Statistics, Board of Governors

Mr. Whitesell, Assistant Director,  
Division of Monetary Affairs,  
Board of Governors

Ms. Low, Open Market Secretariat  
Assistant, Division of Monetary  
Affairs, Board of Governors

Mr. Lyon, First Vice President, Federal  
Reserve Bank of Minneapolis

Ms. Browne, Messrs. Hakkio, Hunter,  
Kos, Ms. Mester, Messrs. Rolnick  
and Rosenblum, Senior Vice  
Presidents, Federal Reserve Banks  
of Boston, Kansas City, Chicago,  
New York, Philadelphia,  
Minneapolis, and Dallas  
respectively

Messrs. Cunningham and Gavin,  
Vice Presidents, Federal Reserve  
Banks of Atlanta and St. Louis  
respectively

By unanimous vote, the minutes of  
the meeting of the Federal Open Market  
Committee held on November 15, 2000,  
were approved.

The Manager reported on develop-  
ments in domestic financial markets and  
on System open market transactions  
in government securities and federal  
agency obligations during the period  
November 15, 2000, through Decem-  
ber 18, 2000. By unanimous vote, the  
Committee ratified these transactions.

The Manager of the System Open  
Market Account also reported on recent  
developments in foreign exchange mar-  
kets. There were no open market opera-  
tions in foreign currencies for the Sys-  
tem's account in the period since the  
previous meeting.

The Committee then turned to a dis-  
cussion of the economic situation and  
outlook and the implementation of  
monetary policy over the intermeeting  
period ahead.

The information reviewed at this  
meeting provided evidence that eco-  
nomic activity, which had expanded at  
an appreciably lower pace since mid-  
year, might have slowed further in  
recent months. Consumer spending and  
business purchases of equipment and  
software had decelerated markedly after  
having registered extraordinary gains in

the first half of the year. Housing construction, though still relatively firm, was noticeably below its robust pace of earlier in the year. With final spending rising at a reduced rate, inventory overhangs had emerged in a number of goods-producing industries, most visibly in the motor vehicle sector. Manufacturing production had declined as a consequence, and the rate of expansion in employment had moderated further. Evidence on core price inflation was mixed; by one measure, it appeared to be increasing very gradually, in part reflecting the indirect effects of higher energy costs, but by another it had remained at a relatively subdued level.

Growth in private nonfarm payroll employment moderated a little further on balance in October and November. Manufacturing payrolls changed little over the two months, and job gains in the construction, retail trade, and services industries were smaller than those of earlier in the year. By contrast, the pace of hiring remained relatively brisk in the finance, insurance, and real estate sectors. With growth in the demand for labor slowing, initial claims for unemployment insurance continued to trend upward, and the civilian unemployment rate edged up to 4 percent in November, its average thus far this year.

Industrial production declined slightly in October and November following a moderate third-quarter increase that was well below the pace of expansion recorded during the first half of the year. Utilities output surged in November in response to unseasonably cold weather across much of the country while mining activity changed little. In manufacturing, motor vehicle output was scaled back further in November, and there also were widespread declines in industries not directly affected by conditions in the motor vehicle sector. Although the production of high-tech equipment was still

trending up, growth continued to slow from the extraordinarily rapid increases of earlier in the year. The weakening of factory output in November was reflected in a further decline in the rate of capacity utilization in manufacturing to a point somewhat below its long-term average.

Consumer spending appeared to be decelerating noticeably further in the fourth quarter in an environment of diminished consumer confidence, smaller job gains, and lower stock prices. Retail sales were down somewhat on balance in October and November after a substantial third-quarter increase; sales of light vehicles dropped over the two months, and growth in expenditures on other consumer goods slowed. Outlays on services continued to grow at a moderate rate through October (latest data).

Against the backdrop of declining interest rates on fixed-rate mortgages, residential building activity had leveled out since midyear, and October starts remained at the third-quarter level. Sales of new homes edged down in October, though they were still slightly above their third-quarter level; sales of existing homes slipped somewhat in October but were near the middle of their range over the past year. In the multifamily sector, starts moved up slightly further in October, though they remained appreciably below their elevated level during the first half of the year. Continuing relatively low vacancy rates for multifamily units suggested that the prospects for additional construction were favorable.

Business investment in equipment and software increased at a sharply lower, though still relatively robust, rate in the third quarter, and information on shipments of nondefense capital goods indicated another moderate increase in business investment in October. Ship-

ments of communications, computing, and office equipment were well above their third-quarter averages, and shipments of non-high-tech equipment turned up in October after having fallen appreciably in earlier months. On the downside, sales of medium and heavy trucks declined further over October and November, and new orders for such trucks remained weak. Investment in nonresidential structures continued to rise briskly in October, and all the major subcategories of construction put in place were up substantially on a year-over-year basis. Market fundamentals, including rising property values and low vacancy rates, suggested that further expansion of nonresidential building activity, particularly office construction, was likely.

Inventory investment on a book-value basis picked up in October from the third-quarter pace, and the aggregate inventory-sales ratio edged up to its highest level in the past twelve months. In manufacturing, sizable increases in stocks were led by large accumulations at producers of industrial and electrical machinery. As a result, the stock-sales ratio for manufacturing reached its highest level in a year; advances in stock-sales ratios were widespread among makers of durable goods while ratios remained high for a number of categories of nondurable products. At the wholesale level, inventory accumulation inched up from its third-quarter rate, and the sector's inventory-sales ratio was at the top of its range for the past twelve months. Total retail stocks rose in line with sales in October, and the inventory-sales ratio for this sector also remained at the upper end of its range over the past year.

The U.S. trade deficit in goods and services reached a new record high in September and on a quarterly average basis was up appreciably further in the

third quarter. The value of exports continued to grow strongly in the latest quarter, led by advances in exported machinery and industrial supplies. The value of imports rose at an even faster rate than exports, with increases in all major trade categories, especially industrial supplies, semiconductors, and services. Economic growth in the foreign industrial countries slowed moderately in the third quarter, and the available information suggested a further reduction in the fourth quarter. Economic expansion eased in the euro area despite continued strong growth of investment and exports, as consumer spending appeared to be damped by earlier interest rate increases and by the drain on spendable income of higher prices for oil and imported goods more generally. In addition, weak consumption appeared to be an important factor in continued sluggish economic growth in Japan. Economic activity also decelerated in some developing countries in the third quarter, with recent indicators suggesting a slowdown in expansion in many parts of East Asia.

Incoming data indicated that, on balance, price inflation had picked up only a little, if at all. Consumer prices, as measured by the consumer price index (CPI) on a total and a core basis, rose mildly in October and November after a sizable September increase, but on a year-over-year basis core CPI prices increased noticeably more in the twelve months ended in November than in the previous twelve-month period. When measured by the personal consumption expenditure (PCE) chain-type index, however, consumer price inflation was modest in both October (latest data) and the twelve months ended in October, with little change year over year. At the producer level, core prices edged down on balance in October and November; moreover, producer inflation eased

somewhat on a year-over-year basis, though the deceleration was more than accounted for by an earlier surge in tobacco prices during the year ended in November 1999. With regard to labor costs, average hourly earnings of production or nonsupervisory workers increased in November at the slightly higher rate recorded in October. For the twelve months ended in October, average hourly earnings rose somewhat more than in the previous twelve months.

At its meeting on November 15, 2000, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with an unchanged federal funds rate of about 6½ percent. In taking that action, the members noted that despite clear indications of a more moderate expansion in economic activity, persisting risks of heightened inflation pressures remained a concern, particularly in the context of a gradual upward trend in core inflation. In these circumstances, a steady monetary policy was the best means to promote price stability and sustainable economic expansion. While recognizing that growth was slowing more than had been anticipated and that developments might be moving in a direction that would require a shift to a balanced risk statement, members agreed that such a change would be premature. As a result, they agreed that the statement accompanying the announcement of their decision should continue to indicate that the risks remained weighted mainly in the direction of rising inflation.

Open market operations throughout the intermeeting period were directed toward maintaining the federal funds rate at the Committee's targeted level of 6½ percent, and the average rate remained close to the intended level. Against the background of deteriorating

conditions in some segments of financial markets, slower economic expansion, and public comments by Federal Reserve officials about the implications of those developments, market expectations about the future course of the federal funds rate were revised down appreciably over the intermeeting period, and market interest rates on Treasury and private investment-grade securities declined somewhat over the intermeeting interval. The weaker outlook for economic growth, coupled with growing market concerns about corporate earnings, weighed down equity prices and boosted risk spreads on lower-rated investment-grade and high-yield bonds. Equity prices were quite volatile during the intermeeting period, and reflecting numerous dour reports on corporate earnings and incoming information indicating slower growth in economic activity in the United States, broad indexes of stock market prices dropped considerably on balance over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar edged lower on balance over the intermeeting interval in terms of the currencies of a broad group of U.S. trading partners. Among the major foreign currencies, the dollar fell moderately against the euro but moved up by a roughly comparable extent in terms of the yen. The dollar's decline against the euro reflected a growing perception that economic expansion in the euro area would cool comparatively less than in the United States. Correspondingly, the slide of the yen seemed to be related to weak economic data, stagnant business sentiment, and political uncertainties in Japan. The dollar posted a small gain against an index of the currencies of other important trading partners, largely reflecting weaker financial conditions in some emerging economies.



The broad monetary aggregates decelerated further in November. The slowing growth of M2 in October and November following strong expansion in August and September apparently reflected the moderating rates of increase in nominal income and spending in recent months and perhaps some persisting effects of the rise in opportunity costs earlier in the year. M3 growth slowed less than that of M2 in November, in part because of stepped-up issuance of large time deposits as banks reduced their reliance on funding from overseas offices. The growth of domestic nonfinancial debt slowed in October (latest data), reflecting a larger further paydown of federal debt and a reduced pace of private borrowing.

The staff forecast prepared for this meeting suggested that the economic expansion had slowed considerably, to a rate somewhat below the staff's current estimate of the growth of the economy's potential output, but that it would gradually gain strength over the next two years. The forecast anticipated that the expansion of domestic final demand would be held back to some extent by the diminishing influence of the wealth effects associated with past outsized gains in equity prices but also by the relatively high interest rates and the somewhat stringent credit terms and conditions on some types of loans by financial institutions. As a result, growth of spending on consumer durables was expected to be appreciably below that in recent quarters, and housing demand to be slightly weaker. Business fixed investment, notably outlays for equipment and software, was projected to remain relatively robust; growth abroad would support the expansion of U.S. exports; and fiscal policy was assumed to continue its moderate expansionary trend. Core price inflation was projected to rise only slightly over the forecast

horizon, partly as a result of higher import prices but also as a consequence of some further increases in nominal labor compensation gains that would not be fully offset by the expected growth of productivity.

In the Committee's discussion of current and prospective economic developments, members commented that recent statistical and anecdotal information provided clear indications of significant slowing in the expansion of business activity and also pointed to appreciable erosion in business and consumer confidence. The deceleration in the economy had occurred from an unsustainably high growth rate in the first half of the year, and the resulting containment in demand pressures on resources already had improved the outlook for inflation. The question at this juncture was whether the expansion would remain near its recent pace or continue to moderate. While the former still seemed to be the most likely outcome, the very recent information on labor markets, sales and production, business and consumer confidence, developments in financial markets, and growth in foreign economies suggested that the risks to the economy had shifted rapidly and perceptibly to the downside. Concerning the outlook for inflation, members commented that the upside risks clearly had diminished in the wake of recent developments and that, with pressures on resources likely to abate at least a little, subdued inflation was a reasonable prospect.

Weakening trends in production and employment were most apparent in the manufacturing sector. There were widespread anecdotal reports of production cutbacks, notably in industries related to motor vehicles, and of associated declines in manufacturing employment. However, many of the factory workers losing their jobs were readily finding

employment elsewhere in what generally continued to be characterized as very tight labor markets across the country. The softening in manufacturing reflected weak sales and prompt efforts to limit unwanted buildups in inventories. Even so, business contacts reported currently undesired levels of inventories in a range of industries, not only in motor vehicles. In the aggregate, cutbacks in inventory investment or run-offs of existing inventories accounted for a significant part of the recent moderation in the growth of the overall economy.

The slowing in the growth of consumer spending that had prompted much of the backup in inventories was evident from a wide variety of information, including anecdotal reports from various parts of the country. Consumer sentiment seemed to have deteriorated appreciably in recent weeks, though from a very high level, and retail sales were widely indicated to have softened after a promising spurt early in the holiday season. Factors cited to account for the relatively sudden emergence of this weakness, and also as possible harbingers of developments in coming quarters, were the negative wealth effects of further declines in stock market prices, the impact of very high energy costs on disposable incomes, and some increase in caution about the outlook for employment opportunities and incomes. The extent to which such developments would persist and perhaps foster more aggressive retrenchment in consumer spending clearly was uncertain, but the members nonetheless anticipated that over time underlying employment and income trends would be consistent with further expansion in consumer expenditures, though at a pace well below that of earlier in the year.

Growth in business expenditures for equipment and software had moderated

substantially in recent months from very high rates of increase over an extended period. The slowdown reflected a mix of interrelated developments including flagging growth in demand and tightening financial conditions in the form of declining equity prices and stricter credit terms for many business borrowers. The re-evaluation of prospects was most pronounced in the high-tech industries. The profitability of using and producing such software and equipment had been overestimated to a degree, and disappointing sales and a better appreciation of risks had resulted in much slower growth in production of such equipment and sharp deterioration in the equity prices of high-tech companies. At the same time, nonresidential construction activity appeared to have been well maintained in many parts of the country, though there were reports of softening in some regions and of some reductions or delays in planned projects. Against this background, risks of further retrenchment in capital spending persisted, but to date there was no evidence to suggest that the underlying pace of advances in technology and related productivity growth had abated. Over time, further increases in productivity would undergird continuing growth in demand for high-tech equipment. In the nonresidential construction area, members noted that high occupancy rates and high rents were supportive elements in the construction outlook.

With regard to the prospects for housing activity, members provided anecdotal reports of some weakening in a number of regions, though homebuilding was holding up well in others. Housing demand was, of course, responding to many of the same factors that were affecting consumer spending, including the negative wealth effects of declining stock market prices. On the positive side, further growth in incomes and

declines in mortgage rates were key elements of underlying strength for the housing sector. On balance, housing construction at a pace near current levels appeared to be a reasonable prospect in association with forecasts of moderate growth in the overall economy.

Growth in foreign economic activity likely would continue to foster expansion in U.S. exports, though members noted that there were signs of softer business conditions in some foreign nations. In addition, members referred to some anecdotal evidence of increasing concern among business contacts about future prospects for exports of manufactured goods. On the other hand, any depreciation in the foreign exchange value of the dollar as the economy slowed would help to bolster exports.

Against the backdrop of slowing economic growth, core inflation had remained quiescent. Views regarding the outlook for inflation were somewhat mixed, though all the members agreed that the risks of higher inflation had diminished materially. Nonetheless, some members noted that while recent anecdotal reports pointed to a modest reduction in labor market strains in some areas and industries, labor markets in general were still very tight and likely would remain taut relative to historical experience. In such circumstances, if structural productivity growth leveled out, worker efforts to catch up to past increases in productivity could put pressures on labor compensation costs. The latter could well be augmented by sharply rising medical costs and by attempts to protect the purchasing power of wages from the erosion caused by the rise in energy prices. Further depreciation of the dollar in relation to major foreign currencies would add to import prices and domestic inflation pressures. But there were also a number of reasons for optimism about the outlook for con-

sumer prices over coming quarters. Growth in economic activity at a pace somewhat below that of the economy's output potential would lessen pressures on labor and other resources from levels that had, in the past few years, been associated with at most a small uptick in core inflation. Indications that rapid growth in structural productivity would persist and widespread reports that strong competitive pressures in most markets continued to inhibit business efforts to increase prices in the face of rising costs also were favorable factors in the outlook. Further declines in oil prices, as evidenced by quotations in futures markets, would if realized have effects not only on so-called headline inflation but would help hold down core prices over time. Despite previous increases in headline inflation, survey and other measures of inflation expectations continued to suggest that long-run inflation expectations had not risen and might even have fallen a bit of late as the economy softened.

In the Committee's discussion of policy for the intermeeting period ahead, all the members indicated that they could support an unchanged policy stance, consistent with a federal funds rate averaging about 6½ percent. However, they also endorsed a proposal calling for a shift in the balance of risks statement to be issued after this meeting to express the view that most members believed the risks were now weighted toward conditions that could generate economic weakness in the foreseeable future. In their evaluation of the appropriate policy for these changing circumstances, the members agreed that the critical issue was whether the expansion would stabilize near its recent growth rate or was continuing to slow. In the view of almost all the members, the currently available information bearing on this issue was not sufficient to warrant an

easing at this point. Much of the usual aggregative data on spending and employment, although to be sure available only with a lag, continued to suggest moderate economic expansion. The information pointing to further weakness was very recent and to an important extent anecdotal. As a consequence, most of the members were persuaded that a prudent policy course would be to await further confirmation of a weakening expansion before easing, particularly in light of the high level of resource utilization and the experience of recent years when several lulls in the growth of the economy had been followed by a resumption of very robust economic expansion. Additional evidence of slowing economic growth might well materialize in the weeks immediately ahead—from the regular aggregated monthly data releases, but also from weekly readings on the labor market and reports from businesses on the strength of sales and production—and the members agreed that the Committee should be prepared to respond promptly to indications of further weakness in the economy. Those few members who expressed a preference for easing at this meeting believed that, with unit labor costs and inflation expectations contained, enough evidence of further weakness already existed to warrant an immediate action. Nonetheless, they could accept a delay in light of prevailing uncertainties about the prospective performance of the economy and the intention of the Committee to act promptly in coming weeks, including the possibility of an easing move early in the intermeeting period, should confirming information on weakening trends in the economy emerge.

With regard to the consensus in favor of moving from an assessment of risks weighted toward rising inflation to one that was weighted toward economic

weakness, with no intermediate issuance of a balanced risks assessment, some members observed that such a change was likely to be viewed as a relatively rapid shift by some observers. The revised statement of risks, even though it would not be associated with an easing move, could strengthen expectations regarding future monetary policy easing to an extent that was difficult to predict and could generate sizable reactions in financial markets. At the same time, it might raise questions about why the Committee did not alter the stance of policy. Nonetheless, the Committee's reasons for not easing today were deemed persuasive by most members, while shifting its statement about economic risks seemed clearly justified by recent developments. In one view, even though the risks of a weakening economy had increased, a statement of balanced risks would be preferable because further moderation in the expansion might well fail to materialize.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 6½ percent.

The vote also encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable eco-

conomic growth and of the information currently available, the Committee believes that the risks are weighted mainly toward conditions that may generate economic weakness in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Broadbent, Ferguson, Gramlich, Guynn, Jordan, Kelley, Meyer, and Parry. Votes against this action: None.

This meeting adjourned at 1:35 p.m. with the understanding that the next regularly scheduled meeting of the Committee would be held on Tuesday–Wednesday, January 30–31, 2001.

### Telephone Conference Meeting

A telephone conference meeting was held on January 3, 2001, for the purpose of considering a policy easing action. In keeping with the Committee's Rules of Organization, the members at the start of the meeting unanimously re-elected Alan Greenspan as Chairman of the Federal Open Market Committee and William J. McDonough as Vice Chairman. Their terms of office were extended for one year until the first meeting of the Committee after December 31, 2001. By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after December 31, 2001.

At its meeting on December 19, 2000, the Committee had contemplated the possibility that ongoing economic and financial developments might warrant a reassessment of the stance of monetary policy before the next scheduled meeting in late January. Information that had become available since the December meeting tended to confirm that the economic expansion had continued to weaken. The manufacturing sector was especially soft, reflecting apparent

efforts in a number of industries to reduce inventories that were now deemed to be too high, notably those related to motor vehicles. Retail sales were appreciably below business expectations for the holiday season despite some pickup in the latter half of December, apparently largely induced by price discounting, and sales of motor vehicles evidenced significant further weakness as the month progressed. Business confidence appeared to have deteriorated further since the December meeting amid widespread reports of reductions in planned production and capital spending. Elevated energy costs were continuing to drain consumer purchasing power and were adding to the costs of many business firms, with adverse effects on profits and stock market valuations. Interacting with these developments were forecasts of further declines in business profits over coming quarters. On the more positive side, housing activity appeared to be responding to lower mortgage interest rates, and on the whole nonresidential construction activity seemed to be reasonably well maintained. Moreover, while the expansion had weakened and economic activity might remain soft in the near term, the longer-term outlook for reasonably sustained economic expansion, supported by easier financial conditions and the response of investment and consumption to rising productivity and living standards, was still quite good. Inflation expectations appeared to be declining, with businesses continuing to encounter marked and even increased resistance to their efforts to raise prices. On balance, the information already in hand indicated that the expansion clearly was weakening and by more than had been anticipated. In the circumstances, prompt and forceful policy action sooner and larger than expected by financial markets seemed called for.

Against this background, all the members supported a proposal for an easing of reserve conditions consistent with a reduction of 50 basis points in the federal funds rate to a level of 6 percent. The Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with a reduction in the federal funds rate to an average of around 6 percent.

The vote encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting:

Against the background of its long-run goals of price stability and sustainable eco-

nomic growth and of the information currently available, the Committee believes that the risks are weighted mainly toward conditions that may generate economic weakness in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, Ferguson, Gramlich, Hoenig, Kelley, Meyer, Minehan, Moskow, and Poole. Votes against this action: None.

Chairman Greenspan indicated that shortly after this meeting the Board of Governors would consider pending requests by several Federal Reserve Banks to reduce the discount rate by 25 basis points. At the time of this conference call meeting, no pending requests for a 50 basis point reduction were outstanding, but the press release would indicate that the Board would be prepared to consider requests for further reductions of 25 basis points if they were received.

Donald L. Kohn  
Secretary

## Litigation

During 2000 the Board of Governors was a party in eighteen lawsuits or appeals filed that year and was a party in nine other cases pending from previous years, for a total of twenty-seven cases; in 1999, the Board had been a party in a total of twenty-three cases. One of the actions filed in 2000 raised questions under the Bank Holding Company Act. As of December 31, 2000, sixteen cases were pending.

### Judicial Review of Board Orders under the Bank Holding Company Act

*Dime Bancorp, Inc. v. Board of Governors*, No. 00-4249 (2nd Circuit, filed December 11, 2000), is a petition for review of a Board order dated September 27, 2000, approving the applications of North Fork Corporation, Inc., Melville, New York, to acquire control of Dime Bancorp, Inc. and to thereby acquire its wholly owned subsidiary, The Dime Savings Bank of New York, FSB, both of New York, New York (86 *Federal Reserve Bulletin* 767).

*Irontown Housing Corp. v. Board of Governors*, No. 99-9549 (10th Circuit, filed December 27, 1999), was a petition for review of a Board order dated December 13, 1999, approving the merger of First Security Corporation and Zions Bancorporation, both of Salt Lake City, Utah (86 *Federal Reserve Bulletin* 122). On June 28, 2000, the court dismissed the petition for review.

### Litigation under the Financial Institutions Supervisory Act

In *Board of Governors v. Interfinancial Services, Ltd.*, No. 00-5233 (D.C. Cir-

cuit, filed June 27, 2000), appellant sought review of a district court order enforcing an administrative subpoena issued by the Board. On June 30, 2000, the court of appeals denied the appellant's motion for a stay of the district court order, and on December 1, 2000, the court dismissed the case on appellant's motion.

*Board of Governors v. Pharaon*, No. 91-CIV-6250 (S.D. New York, filed September 17, 1991), is an action brought to recover assets of an individual subject to a civil money penalty imposed by the Board. The case was remanded from the U.S. Court of Appeals for the Second Circuit for determination of the penalty amount following the court of appeals' determination requiring a 10 percent surcharge and prejudgment interest on the penalty imposed.

### Other Actions

*Howe v. Bank for International Settlements*, No. 00CV12485 RCL (D. Massachusetts, filed December 7, 2000), is an action seeking damages in connection with gold market activities and the repurchase of privately owned shares of the Bank for International Settlements.

*Barnes v. Reno*, No. 1:00CV02900 (D. District of Columbia, filed December 4, 2000), is a civil rights action naming a Federal Reserve employee as a defendant.

*Guerrero v. United States*, No. 99-6771 (E.D. California, service effected November 21, 2000), is a prisoner suit naming the Federal Reserve as a defendant.

*El Bey v. United States*, No. 00-5293 (D.C. Circuit, filed August 31, 2000), is

an appeal from a district court order dismissing a pro se action against the Federal Reserve and other defendants as lacking an arguable basis in law.

*Sedgwick v. Board of Governors*, No. 00-16525 (9th Circuit, filed August 16, 2000), is an appeal of the district court's dismissal of an action under the Federal Tort Claims Act alleging violation of bank supervision requirements.

*Individual Reference Services Group, Inc. v. Board of Governors et al.*, No. 00-CV-1828 (ESH) (D. District of Columbia, filed July 28, 2000), is an action under the Administrative Procedure Act challenging a portion of an interagency rule regarding privacy of consumer financial information. The action has been consolidated with a separate action, *Trans Union LLC v. Board of Governors et al.*, No. 00-CV-2087 (ESH) (D. District of Columbia, filed August 30, 2000), challenging the same rule.

*Reed Elsevier Inc. v. Board of Governors*, No. 00-1289 (D.C. Circuit, filed June 30, 2000), is a petition for review of an interagency rule regarding privacy of consumer financial information.

*Mann v. Greenspan*, No. CIV-00-754-C (W.D. Oklahoma, filed April 18, 2000), was an employment discrimination action by an employee of a Federal Reserve Bank. On May 10, 2000, the plaintiff voluntarily dismissed the Board as a party.

*Bettersworth v. Board of Governors*, No. 00-50262 (5th Circuit, filed April 14, 2000), is an appeal of the district court's February 17, 2000, dismissal of appellant's Privacy Act claims.

*Hunter v. Board of Governors*, No. 00-CV-735 (D. District of Columbia, filed April 5, 2000), was an action claiming retaliation for alleged whistle-

blowing. The action was dismissed on December 15, 2000.

*Bennett v. Federal Bureau of Investigation et al.*, No. H-00-0707 (S.D. Texas, filed March 1, 2000), was an action alleging Board interference with a private investment. On October 20, 2000, the district court dismissed the action.

*Albrecht v. Board of Governors*, No. 00-CV-317 (CKK) (D. District of Columbia, filed February 18, 2000), is an action challenging the method of funding of the retirement plan for certain Board employees.

*Folstad v. Board of Governors*, No. 00-1056 (6th Circuit, filed January 15, 2000), was an appeal of a district court order granting summary judgment to the Board on a Freedom of Information Act case. On October 26, 2000, the court of appeals affirmed the district court order.

*Toland v. Internal Revenue Service, Federal Reserve System, et al.*, No. CV-S-99-1769-JBR-RJJ (D. Nevada, filed December 29, 1999), was a challenge to income taxation and Federal Reserve notes. On May 1, 2000, the court granted the government's motion to dismiss the action.

*Wasserman v. Board of Governors*, No. 99-6290 (2nd Circuit, filed October 27, 1999), was an appeal of the denial of various post-dismissal motions following the voluntary dismissal of the appellant's district court action. On January 19, 2000, the court of appeals dismissed the case.

*Artis v. Greenspan*, No. 1:99CV02073 (EGS) (D. District of Columbia, filed August 3, 1999), is an employment discrimination action.

*Sheriff Gerry Ali v. U.S. State Department*, No. 99-7438 (C.D. California, filed July 21, 1999), was an action relating to impounded bank drafts. On



December 23, 1999, the court stayed the action pending plaintiff's retaining counsel or returning to the United States.

*Kerr v. Department of the Treasury*, No. 99-16263 (9th Circuit, filed April 28, 1999), was an appeal of the district court's dismissal of an action challenging income taxation and Federal Reserve notes. The district court's dismissal was affirmed on July 13, 2000.

*Nelson v. Greenspan*, No. 1:99-CV00215 (EGS) (D. District of Columbia, filed January 28, 1999), is an employment discrimination complaint.

In *Fraternal Order of Police v. Board of Governors*, No. 98-3116 (D. District of Columbia, filed December 22, 1998), plaintiff seeks a declaratory judgment regarding the Board's labor practices.

*Hunter v. Board of Governors*, No. 1:98CV02994 (TFH) (D. District of Columbia, filed December 9, 1998), was an action under the Freedom of Information Act, the Privacy Act, and the First Amendment. On May 10, 2000, the district court granted the Board's motion for summary judgment, and on August 25, 2000, it denied plaintiff's request for attorney fees. ■